

# RENEGOTIATION ACT AMENDMENTS OF 1981

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ORIGINAL

**HEARING**  
BEFORE THE  
**SUBCOMMITTEE ON**  
**GENERAL OVERSIGHT AND RENEGOTIATION**  
OF THE  
**COMMITTEE ON**  
**BANKING, FINANCE AND URBAN AFFAIRS**  
**HOUSE OF REPRESENTATIVES**  
**NINETY-SEVENTH CONGRESS**  
FIRST SESSION  
ON  
**H.R. 5651**

A bill to revise and reinstate the Renegotiation Act of 1951

AUGUST 4, 1982

**Serial No. 97-82**

Printed for the use of the Committee on Banking, Finance and Urban Affairs



COMPLETED

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# RENEGOTIATION ACT AMENDMENTS OF 1981

WEDNESDAY, AUGUST 4, 1982

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,  
SUBCOMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATION,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 11 a.m., in room 2128, Rayburn House Office Building, Hon. Joseph G. Minish (chairman of the subcommittee) presiding.

Present: Representatives Minish, Annunzio, Barnard, Parris, McCollum, Weber, and Wortley.

Chairman MINISH. The subcommittee will be in order.

The Subcommittee on General Oversight and Renegotiation begins hearings on H.R. 5651, a bill to revise and reinstate the Renegotiation Act of 1951. A copy of the bill will be included in the record at this point.

[The text of H.R. 5651 follows:]

97TH CONGRESS  
2D SESSION

# H. R. 5051

To revise and reinstate the Renegotiation Act of 1951.

## IN THE HOUSE OF REPRESENTATIVES

MARCH 1, 1982

Mr. MINISH (for himself, Mr. SCHUMER, Mr. MURPHY, Mr. MITCHELL of Maryland, Mr. GONZALEZ, Mr. DWYER, Mrs. BOUQUARD, Mr. OTTINGER, Mr. REDELL, and Ms. FERRARO) introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

## A BILL

To revise and reinstate the Renegotiation Act of 1951.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 SHORT TITLE

4 SECTION 1. This Act may be cited as the "Renegoti-  
5 ation Act Amendments of 1981".

6 CONTRACTS SUBJECT TO RENEGOTIATION

7 SEC. 2. Section 102 of the Renegotiation Act of 1951  
8 (50 U.S.C. App. 1212) is amended by adding at the end  
9 thereof the following:

10 "(f) CERTAIN AMOUNTS RECEIVED AFTER OCTOBER  
11 1, 1976.—Notwithstanding the provisions of subsection (a),

1 the provisions of this title shall not apply to contracts with  
2 Departments, or related subcontracts, to the extent of the  
3 amounts received or accrued by a contractor or subcontractor  
4 during the period beginning on October 1, 1976, and ending  
5 on the date of the enactment of this subsection.”.

6

#### TERMINATION DATE

7 SEC. 3. The last sentence of section 102(c)(1) of the  
8 Renegotiation Act of 1951 (50 U.S.C. App. 1212(c)(1)) is  
9 amended to read as follows: “For purposes of this title, the  
10 term ‘termination date’ means September 30, 1986.”.

11

#### METHOD OF RENEGOTIATION

12 SEC. 4. Section 105(a) of the Renegotiation Act of 1951  
13 (50 U.S.C. App. 1215(a)) is amended by inserting after the  
14 sixth sentence thereof the following: “The Board shall re-  
15 negotiate all contracts and subcontracts by division and by  
16 major product line within a division of the contractor or sub-  
17 contractor.”.

18

#### MINIMUM AMOUNT SUBJECT TO RENEGOTIATION

19 SEC. 5. Section 105(f) of the Renegotiation Act of 1951  
20 (50 U.S.C. App. 1215(f)) is amended—

21

22 (1) in paragraph (1), by inserting “, or  
23 \$5,000,000 in the case of a fiscal year ending after the  
24 date of the enactment of the Renegotiation Act  
25 Amendments of 1981” after “June 30, 1956” each  
place it appears therein;

1           (2) in the second sentence of paragraph (3), by in-  
2       serting "the \$5,000,000 amount," after "the  
3       \$1,000,000 amount,"; and

4           (3) in the last sentence of paragraph (3), by strik-  
5       ing out "\$1,000,000" each place it appears therein  
6       and inserting in lieu thereof "\$5,000,000".

7                               **EFFECTIVE DATE**

8       **SEC. 6.** The amendments made by this Act shall take  
9       effect on the date of the enactment of this Act.

Chairman MINISH. There are clear and compelling reasons for my reintroduction of this legislation at this time. We are presently preparing to engage in a procurement program that will cost somewhere in excess of \$1 trillion in the next 5 years.

The current administration has committed the country to the largest peacetime military buildup in this Nation's history. The House has approved a \$175.3 billion defense authorization bill for next year. That figure is a \$46 billion increase in spending over fiscal year 1982.

We are spending all this money in an industry which is almost completely devoid of competition. In the recent past over 60 percent of all our military procurement money went to sole source contractors. The result of this sole source procurement is in essence an opportunity for many defense contractors to deal with this Nation's Armed Forces on a take-it-or-leave-it basis.

There is no question that if we had true competition in the marketplace of defense contracting there would be less worry about unreasonably high profits. However, this is not the case. The record of the past is replete with examples of excessive profits, and it is for this reason that I am convinced H.R. 5651 is a necessary stopgap in our system of checks and balances.

In addition to revising and reinstating the Renegotiation Act of 1951, H.R. 5651 will accomplish extending the act from the date of reenactment until a terminating date of September 30, 1986.

Under the legislation, renegotiation will be conducted by division and major product line within that division. This provision should be especially effective in preventing the large conglomerates from averaging profits and losses from unrelated product lines in order to escape the renegotiation process.

Product line renegotiation also recognizes that since the Renegotiation Act was first passed in 1951, the structure and competitiveness of American businesses has been drastically altered. Today, unlike 1951, we have a large number of corporations engaged in a multitude of unrelated businesses.

The bill would also raise the minimal level of annual sales from the prior amount of \$1 million to a present threshold of \$5 million. This would allow many of the smallest Government contractors who had paid a disproportionate share of excess profit determinations to escape the process entirely.

May I say in concluding my remarks that we who represent the American taxpayers should do our utmost to see that the act is continued. I believe it is one way of saving some of our precious dollars from escaping in excess profits.

We are starting late this morning and we have a number of witnesses with prior commitment. I, therefore, ask that the witnesses confine their oral presentation to as brief a period as possible without losing the tenor of their presentations. Congressman Jack Brooks will not be present this morning to give testimony. He has sent his statement to me by page and it will be inserted into the record.

[The statement of the Honorable Jack Brooks follows:]

STATEMENT OF CONGRESSMAN JACK BROOKS  
HEARING ON H. R. 5051, TO REVISE AND REINSTATE THE RENEGOTIATION  
ACT OF 1951  
SUBCOMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATION  
WEDNESDAY, AUGUST 4, 1982

FIRST OF ALL, MR. CHAIRMAN, I WANT TO COMMEND YOU FOR YOUR PATIENCE AND PERSISTENCE IN YOUR LONG EFFORT TO REVITALIZE, AND NOW REVIVE, THE RENEGOTIATION BOARD. I ALSO MUST COMMEND YOU FOR YOUR OPTIMISM.

I RECALL THE MANY BATTLES WE FOUGHT FIVE OR SIX YEARS AGO WHEN THE RENEGOTIATION BOARD WAS FIGHTING FOR ITS LIFE AGAINST THE COMBINED FORCES OF THE DEFENSE INDUSTRY AND THE DEFENSE DEPARTMENT. YOU HELD HEARINGS THAT PRODUCED WHAT ANY IMPARTIAL OBSERVER WOULD HAVE CONCLUDED WAS A SOLID CASE FOR THE PRESERVATION AND STRENGTHENING OF THE RENEGOTIATION BOARD. UNFORTUNATELY, IMPARTIAL OBSERVERS DON'T CAST MANY VOTES IN CONGRESS AND WE WATCHED THE BOARD DWINDLE AWAY AND FINALLY DIE. NOW YOU ARE TRYING TO RESURRECT IT AND I APPLAUD YOUR EFFORT.

WITH DEFENSE SPENDING SOARING TO THE HIGHEST LEVELS IN OUR HISTORY, THE CASE FOR A GOVERNMENT AGENCY WITH AUTHORITY TO REVIEW DEFENSE CONTRACTS AND SEE THAT THEY ARE NOT LEADING TO EXCESS PROFITS FOR THE CONTRACTORS IS STRONGER THAN EVER. YOU WOULD THINK THE PENTAGON WOULD LIKE TO HAVE SOMEONE IT COULD COUNT ON TO MAKE SURE IT IS NOT BEING RIPPED OFF WHEN IT HANDS OUT ITS BILLIONS OF DOLLARS. YOU WOULD THINK THE ADMINISTRATION WOULD LIKE TO PUT IN BUSINESS AN AGENCY THAT WOULD RETURN MILLIONS OF DOLLARS A YEAR TO THE TREASURY INSTEAD OF PUMPING IT OUT. BUT I DON'T HEAR ANY VOICES FROM THE PENTAGON AND THE WHITE HOUSE CALLING FOR SUCH AN AGENCY SO I IMAGINE YOU ARE GOING TO HAVE TO PUSH ON WITHOUT THEIR HELP.

MR. CHAIRMAN, I DON'T KNOW HOW LONG THE PENTAGON IS GOING TO BE ABLE TO GET AWAY WITH ITS HIGH-HANDED, ARROGANT MANNER OF DEALING WITH CONGRESS AND THE PUBLIC. FOR YEARS, THE HOUSE AND SENATE ARMED SERVICES COMMITTEES--AND THEY ARE NOT ENTIRELY UNFRIENDLY TO THE PENTAGON--HAVE TRIED TO GET THEM TO INCREASE COMPETITION IN THEIR PROCUREMENT CONTRACTS. YOU IN THIS SUBCOMMITTEE HAVE CALLED FOR IT. IN OUR GOVERNMENT OPERATIONS COMMITTEE, WE HAVE SHOWN AGAIN AND AGAIN HOW THE PENTAGON'S PREFERENCE FOR SOLE-SOURCE CONTRACTS HAS COST THE GOVERNMENT MILLIONS OF DOLLARS. AND WHAT WAS THEIR RESPONSE?

THEY PUT OUT FIGURES EARLIER THIS YEAR SHOWING A BIG INCREASE IN COMPETITIVE PROCUREMENT. BUT WHEN THE GENERAL ACCOUNTING OFFICE LOOKED AT THE FIGURES, THEY FOUND THAT ALL DOD HAD DONE WAS REDEFINE COMPETITIVE AND NONCOMPETITIVE PROCUREMENT. WHEN YOU APPLIED THE SAME METHOD THEY HAD ALWAYS USED IN THE PAST, YOU FOUND THEIR RECORD FOR COMPETITIVE PROCUREMENT WAS EVEN WORSE THAN IT HAD BEEN.

THE ADMINISTRATION, IN RESPONSE TO A LAW THAT ORIGINATED IN OUR COMMITTEE, IS DRAFTING A GOVERNMENT-WIDE PROCUREMENT CODE THAT WILL STRESS THE IMPORTANCE OF COMPETITION. AND WHAT HAS THE DEFENSE DEPARTMENT DONE? GOTTEN ITSELF EXEMPT FROM THE CODE.

THE AWARDING OF BILLIONS OF DOLLARS TO DEFENSE CONTRACTORS WITHOUT ANY COMPETITIVE BIDDING IS NECESSARY IN MANY CASES FOR THE DEVELOPMENT OF COMPLEX WEAPONS SYSTEMS. BUT IT IS EQUALLY NECESSARY TO MAKE SURE THAT THERE IS NO ABUSE OF THOSE CONTRACTS. THAT PROFITS ARE KEPT IN A REASONABLE RANGE AND THAT WE GET THE MOST DEFENSE WE CAN FOR OUR DEFENSE DOLLARS.

THE RENEGOTIATION BOARD CAN PLAY AN IMPORTANT PART IN PROVIDING THAT ASSURANCE. IT HAS PROVEN ITS WORTH IN THE MILLIONS OF DOLLARS IN EXCESS PROFITS IT UNCOVERED DURING ITS EXISTENCE. IT NEVER SHOULD HAVE BEEN ALLOWED TO DIE AND I HOPE YOU WILL BE SUCCESSFUL IN THIS EFFORT TO BREATHE NEW LIFE INTO IT.

Chairman MINISH. The first witness is a very valued member of the subcommittee, the gentleman from Texas, Mr. Gonzalez. Mr. Gonzalez, you may proceed.

**STATEMENT OF HON. HENRY B. GONZALEZ, A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF TEXAS**

Mr. GONZALEZ. Thank you very much, Mr. Chairman.

I certainly do support H.R. 5651—I am one of the cosponsors—which would reactivate the Renegotiation Board and I commend you once again for your determination and your persistence and your intention to revive the one law that has been effective in deterring war profiteers.

There never has been a time when war profiteers did not exist. In our Nation's history, even during the time that George Washington was suffering in the cold on the Delaware, he had to worry about profiteers. Those who have sought to take undue advantage of emergencies and military exigencies have always been with us.

They have charged exorbitant prices for shoddy merchandise. They have delivered short measures and demanded full prices, and they have profited handsomely throughout all the ages. They are with us still, except they are richer, they are more powerful and more avaricious than ever.

Today we are in the midst of an unprecedented military buildup. The amount of money going into military procurement is beyond the mind of man to comprehend. It is like when we read about the millions in the Holocaust—just the idea of trying to grasp what ten means, much less a million or a thousand. It is the same thing here.

We cannot even envision the \$1.5 trillion that will go into military expenditures in the next 5 years. The quantity of money so vast that we cannot comprehend is so vast, how it can be infallibly managed, as the administration and those ardently supporting it advocate. Inescapably there will be fraud, there will be abuse, there will be profiteering—and all at unprecedented levels.

The administration is fond of saying that in programs like food stamps there is a factor of error, waste or fraud approaching 10 percent. Yet the food stamp program is tightly managed, carefully scrutinized, constantly watched by law enforcement agencies.

Military programs do not get the same kind of scrutiny. There is not any concerted effort to weed out the cheaters and sharp operators. Law enforcement agencies almost never try to prosecute the greedy souls who prey on the riches of the Pentagon.

It is reasonably safe to say that 10 percent of military procurement funds are skimmed off by profiteers. In a \$1.5 trillion program that would be enough to wipe out the whole \$150 billion deficit that we are staring at today. It would be enough to fund food stamps for 15 years. It would be enough to fund all the Nation's housing programs for 5 years. It would be enough to finance student loans for decades to come.

Yet we are doing literally nothing to stop war profiteering, other than the distinguished chairman's efforts and some of the other stalwarts. At the time the Renegotiation Act lapsed, there were \$150 billion in defense contracts that had not even been examined.

In the last 12 months of its work, the Renegotiation Board found \$82 million in excess profits—and that was at a time when the Pentagon spending was small, relatively, compared to the Niagara of spending that is going on today.

The defense authorization bill that we passed just last week carries a total program of \$175 billion. Of the procurement part of that program, we can expect that \$2 out of every \$3 will be spent on negotiated or sole source contracts, not competitive bids—no real, honest-to-goodness competition.

There are reasons why this happens, because military contracts involve complex and peculiar requirements. But no matter how good the arguments are for a noncompetitive contract, the fact remains that such contracts are the most lucrative and such contracts are most likely to involve excessive profits. As the first Secretary of Defense Forrestal himself could not be labeled more of a conservative individual. He saw the absolute need for the scrutiny of contracts and recapture of unjustified profits.

Without the discipline of the marketplace, military contracting is a breeding ground for profiteering. There has to be some force to discourage that profiteering and the Renegotiation Board is that force.

We are, as I have said, spending the greatest amount in history on national defense. We are in the midst of the fastest, broadest buildup ever. Unless we provide some defense against profiteering, history may well record of us that never before in the history of human conduct did so few spend so much on so little.

In its last years, the Renegotiation Board was hedged about with restrictions and crippled with manpower shortages. I myself first got involved in 1967. The Board was on the verge of being killed then, in June 1967. I had to make 18 speeches in its defense. At that time the Board was practically unknown and it was under the jurisdiction of the Ways and Means Committee. Most of the Members were not even aware of its existence. But it was saved nevertheless, to the glory and the credit of the Members then.

Despite its handicaps, the Board found an average of \$38 million a year in excessive profits in its last years, even though it had been crippled by congressional restriction after congressional restriction. If it had been encouraged instead of hamstrung, if it had been supported instead of choked, there is no doubt whatever that the Renegotiation Board would have produced far more than it did—and yet what it produced is astonishing, a truly commendable record of achievement.

We constantly read that major military contracts have gone through a cost overrun. The new FA-18 aircraft, for instance, was supposed to cost \$6 million a copy. The current figure is \$26 million and going up. The contractors usually defend such cost increases by saying that the Pentagon kept adding new features to the weapon—and this is very often the case. But that cannot be the whole explanation and the fact is that nobody is examining the books to see if profiteering might not account for some of these astounding cost overruns.

If profiteering accounts for 10 percent of the defense dollar, the sum is staggering—more than enough in any given year to pay for even a program as vast as food stamps, as I said, more than enough

to finance unemployment compensation, which as you know is beginning to pose quite a problem, at today's historic high rates.

Even if, in fact, profiteering is only 1 percent of the defense dollar, that would still be a staggering amount of money. It would be more than all of the waste, fraud, and abuse that Mr. Reagan claims exists in the whole civilian side of Government put together. Yet there is no demand for rigorous examination and review of defense contracts.

On the day Ronald Reagan became President, there was an immense run-up in the stock prices of major military suppliers. The investors believed that the advent of Ronald Reagan also meant the coming of unprecedented profits for military contractors. How can we fail to see that connection?

There is no need for the Nation to pretend that it cannot see the evil of avaricious contractors. There is no excuse for the Congress to wring its hands over cost overruns. We have a solution within our reach, and that is a revitalized Renegotiation Act. There is no substitute for a watchdog who can bark and bite. That is what we must have. It is what we can have, if we enact H.R. 5651, give reasonable resources to enforce it, and resist the lobbyists who swarm about the Capitol.

The fact of the matter is this, Mr. Chairman. The Reagan administration has placed this country on a war budget. You can call it defense, you can call it what you will, but this is a war budget. What it has failed to do is to levy wartime taxes or to take wartime measures against profiteers.

No one can argue against an adequate defense. I have been for it and am sworn to it. But adequate defense is no excuse for profiteering. In truth and in fact, defense is the last area of any economy that can withstand the ravages of avarice and corruption.

The reactivation of the Renegotiation Act would give us an instrument to recapture excessive profits. It would give our Government some hope of deterring those who would otherwise take advantage of the incredibly large, noncompetitive contracts that are available in almost limitless size today. It would enable us to have more defense for fewer dollars.

The Renegotiation Act is but a small leash to place on a very large beast. We know that the Renegotiation Board did not stop profiteering. But it did discourage it. It did recover tens of millions of tax dollars. And it did serve its purpose well, despite, as I said, the constant crippling effects of congressional inaction.

The test of how well it served is this: the defense industry saw fit to put immense lobby resources into a years-long effort to kill the Renegotiation Board and then to gut the Vinson-Trammell Act. It was good. It was effective, and that is why it was killed. If it had not been effective, as the opponents have manifested all along, why were they so anxious to kill it?

Washington today is in truth a city without shame. Today, influence peddling is open and openly advertised. Today corporate contributions to campaigns are preposterous in size and in their universal availability. Today there is no shame about taking huge sums of money for political purposes, and no shame about using huge sums of money to buy friends and punish opponents.

It is in this kind of shameless atmosphere that we are embarking on this immense military expansion—an atmosphere that openly invites abuse and wanton misuse of public funds.

It would be bad enough if we only faced a situation in which there is little real competition for military contracts. It would be bad enough if there were wartime taxes against excess profits. But not only do we have no real competition; we have no taxes against excess profits derived from Government contracts. We have no real barriers against corruption, not even the force of moral shame. Neither do we even have the slender leash of an agency empowered to review contracts and determine what kind of profit is reasonable.

We have to begin somewhere. The logical place is to enact the pending bill. Again, Mr. Chairman, I commend you for your efforts, and assure you that I will support reactivation of the Renegotiation Act with every means at my command.

Thank you very much for this opportunity. I will say that because of local community officials here present and on an emergency basis I will do my best to get back after 11:30 to the hearings since I am a member of the subcommittee.

[Mr. Gonzalez' prepared statement follows:]

August 4, 1982

Statement of U.S. Representative Henry B. Gonzalez  
Subcommittee on Oversight and Renegotiation

I support H.R. 5651, which would reactivate the Renegotiation Board. I commend Chairman Minish for his determination to revive the one law that has been effective in deterring war profiteers.

There has never been a time when war profiteers did not exist. Those who have sought to take undue advantage of emergencies and military exigencies have always been with us. They have charged exorbitant prices for shoddy merchandise, they have delivered short measures and demanded full prices, and they have profited handsomely throughout all the ages. They are with us still, and they are richer, more powerful, and more avaricious than ever.

Today we are in the midst of an unprecedented military build-up. The amount of money going into military procurement is beyond the mind of man to comprehend. We cannot even envision the one and a half trillion dollars that will go into military expenditures in the next five years. A quantity of money so vast that we cannot comprehend is a quantity of money too vast for infallible management. Inescapably there will be fraud, there will be abuse, and there will be profiteering--all at unprecedented levels.

The Administration is fond of saying that in programs like food stamps, there is a factor of error, waste or fraud approaching 10 per cent. Yet the food stamp program is tightly managed, carefully scrutinized, and constantly watched by law enforcement agencies.

Military programs do not get the same kind of scrutiny. There is not any concerted effort to weed out the cheaters and sharp operators. Law enforcement agencies almost never try to prosecute the greedy souls who prey on the riches of the Pentagon.

It is reasonably safe to say that ten per cent of military procurement funds are skimmed off by profiteers. In a trillion and a half dollar program, that would be enough to wipe out the whole \$150 billion deficit that we are staring at today. It would be enough to fund food stamps for fifteen years. It would be enough to fund all the nation's housing programs for five years. It would be enough to finance student loans for decades to come.

Yet we are doing literally nothing to stop war profiteering. At the time the Renegotiation Act lapsed, there were \$150 billion in defense contracts that had not even been examined. In the last twelve months of its work, the Renegotiation Board found \$82 million in excess profits -- and that was at a time when Pentagon spending was small, compared to the Niagara of spending that is going on today.

The Defense Authorization bill that we passed just last week carries a total program of \$175 billion. Of the procurement part of that program, we can expect that two out of every three dollars will be spent on negotiated or sole source contracts -- not competitive bids, no real competition. There are reasons why this happens, because military contracts involve complex and peculiar requirements. But no matter how good the arguments are for a noncompetitive contract, the fact remains that such contracts are the most lucrative, and such contracts are most likely to involve excessive profits.

Without the discipline of the marketplace, military contracting is a breeding ground for profiteering. There has to be some force to discourage that profiteering, and the Renegotiation Act is that force.

We are, as I have said, spending the greatest amount in history on national defense. We are in the midst of the fastest, broadest buildup ever. Unless we provide some defense against profiteering, history may well record of us that never before in the history of human conduct did so few spend so much on so little.

In its last years, the Renegotiation Board was hedged about with restrictions and crippled with manpower shortages. Despite all that, the Board found an average of \$38 million a year in excessive profits. If it had been encouraged instead of hamstrung, if it had been supported instead of choked, there is no doubt whatever that the Renegotiation Board would have produced far more than it did -- and yet what it produced is astonishing, a truly commendable record of achievement.

We constantly read that major military contracts have gone through a cost overrun. The new FA-18 aircraft, for instance, was supposed to cost \$6 million a copy. The current figure is \$26 million, and going up. The contractors usually defend such cost increases by saying that the Pentagon kept adding new features to the weapon -- and this is very often the case. But that cannot be the whole explanation, and the fact is, nobody is examining the books to see if profiteering might not account for some of these astounding cost overruns. If profiteering accounts for 10 per cent of the defense dollar, the sum is

staggering -- more than enough in any given year to pay for even a program as vast as food stamps -- more than enough to finance unemployment compensation, even at today's historic high rates. If, in fact, profiteering is only one per cent of the defense dollar, that would still be a staggering amount of money -- it would be more than all the waste, fraud and abuse that Mr. Reagan claims exists in the whole civilian side of government put together. Yet there is no demand for rigorous examination and review of defense contracts.

On the day Ronald Reagan became President, there was an immense run-up in the stock prices of major military suppliers. The investors believed that the advent of Ronald Reagan also meant the coming of unprecedented profits for military contractors. How can we fail to see the connection?

There is no need for the nation to pretend that it cannot see the evil of avaricious contractors. There is no excuse for the Congress to wring its hands over cost overruns. We have a solution within our reach, and that is a revitalized Renegotiation Act. There is no substitute for a watchdog who can bark and bite. That is what we must have. It is what we can have, if we enact H.R. 5651, give reasonable resources to enforce it, and resist the lobbyists who swarm about the Capitol.

The fact of the matter is this, Mr. Chairman. The Reagan Administration has placed this country on a war budget. What it has failed to do is to levy wartime taxes, or to take wartime measures against profiteers. No one can argue against an adequate defense, but adequate defense is no excuse for profiteering. In truth, and in fact, defense is the last area of any economy that can withstand the ravages of avarice and corruption.

The reactivation of the Renegotiation Act would give us an instrument to recapture excessive profits. It would give our government some hope of deterring those who would otherwise take advantage of the incredibly large, noncompetitive contracts that are available in almost limitless size today. It would enable us to have more defense for fewer dollars.

The Renegotiation Act is but a small leash to place on a very large beast. We know that the Renegotiation Board did not stop profiteering -- but it did discourage it, it did recover tens of millions of tax dollars, and it did serve its purpose well. The test of how well it served is this: the defense industry saw fit to put immense lobby resources into a years-long effort to kill the Renegotiation Board, and then to gut the Vinson-Trammel Act. It was good, it was effective, and that is why it was killed.

Washington today is in truth a City without shame. Today, influence peddling is open and openly advertised. Today, corporate contributions to campaigns are preposterous in size and in their universal availability. Today, there is no shame about taking huge sums of money for political purposes, and no shame about using huge sums of money to buy friends and punish opponents. It is in this kind of shameless atmosphere that we are embarking on this immense military expansion -- an atmosphere that openly invites abuse and wanton misuse of public funds.

It would be bad enough if we only faced a situation in which there is little real competition for military contracts. It would be

bad enough if there were wartime taxes against excess profits. But not only do we have no real competition; we have no taxes against excess profits derived from government contracts, we have no real barriers against corruption, not even the force of moral shame. Neither do we have even the slender leash of an agency empowered to review contracts and determine what kind of profit is reasonable.

We have to begin somewhere. The logical place is to enact the pending bill -- and again, Mr. Chairman, I commend you for your efforts, and assure you that I will support reactivation of the Renegotiation Act with every means at my command.

Chairman MINISH. Thank you very much, Mr. Gonzalez. There are two votes on the floor. Before we go, the members may ask a few brief questions and we will at least dispose of Mr. Gonzalez.

Do you have any questions?

Mr. ANNUNZIO. Mr. Chairman, I have no questions.

I want to commend my distinguished colleague from Texas for his forthright statement. His position is of no surprise to me. He has fought the good battle for many years. I know the 18 years I have been a Member of Congress Mr. Gonzalez has always been on the side of the, you could say, people, but I believe on the side of the future of our democracy.

He has been an outspoken critic of abuse in Government. He has been a stalwart of defense of human rights. I want to say as I read your statement and listened to you that there is no question that we must travel on the road that you have suggested, and that is the reactivation, because it does not make any sense not to reactivate the Renegotiation Board, especially when the Congress is spending \$175 billion a year or in a 3-year period it is \$1,100 billion.

I think out of sheer necessity responsible Members of the Congress of the United States ought to vote to reinstitute the Renegotiation Board to protect themselves, the taxpayers of this country, and to carry out what a former President so adequately suggested—the military-industrial complex must be watched.

I think this is exactly what we would be doing. I thank you, Mr. Gonzalez.

Mr. GONZALEZ. Thank you.

Chairman MINISH. Mr. Barnard?

Mr. BARNARD. Thank you, Mr. Chairman.

I would also like to say that no Member of Congress is more highly regarded for his conscientious attitude and his diligent efforts than chairman of the Housing Subcommittee, Henry Gonzalez. I know that as he approaches this subject he does it with the same sincerity and the same diligence that he goes about all of his interests and all of his work.

My question is based upon the experience of the Renegotiation Board before, we find that it actually cost more to operate than it returned in additional revenues brought in. It had a very miserable

record of operation. Do you feel that the situation now would be any different than it was before?

Mr. GONZALEZ. First, let me thank my distinguished colleague for his very kind words.

In answer, let me say that the statistical record that I am familiar with does not show that discrepancy between administrative cost and the returns. I think that proportionately through the years as we hedged in its jurisdictional power and its budget—amounts for adequate staff and the like—but mostly the delimitation of its jurisdictional power, that it did relatively less as it progressed into its later years.

But even at that, I think the chairman will bear me out, the \$38 million that I referred to is far over the next operating cost of the Board. It was charged that it did not.

I think that the main problem has always been the one that was posed by the first Secretary of Defense, Secretary Forrestal. You know, he and Chairman Vinson at the time persisted in maintaining this type of an agency, given their experience.

Forrestal, however, had the approach of he thought that if you emphasized the aspect of reward—that is, doing something to foster incentive among the contractors—but the picture then at the time was so different.

Mr. BARNARD. That was during a period of war, though.

Mr. GONZALEZ. No. It was in the postwar period. He was the first Secretary of Defense that in fact single-handedly raised the issue of the continued need of that kind of a watchdog agency.

But his suggestion which he had through bitter experience kind of passed up for the preservation of the Board with its power, such as they were then, was that if there were incentives to the industry such as watching itself and the like that perhaps that would be a better way of discouraging profiteering than the prosecutorial or adversary type of approach. But other than that, he was clear in his absolute need for this type of agency.

But as far as your question as to the net cost compared to what it yielded in its oversight, I think that you may be under a malimpression on that record.

Mr. BARNARD. I think, Mr. Chairman, that during these hearings we should, in all due fairness, look into the matter of how much profits are realized from Government contracts.

I know one of the leading providers of Government contracts is making something like 2.98 percent of total sales.

Chairman MINISH. Well, if the gentleman would yield, I believe the contracts you have been referring to would be in the minority.

Mr. BARNARD. Well, that is what we need to know. We need to have—

Chairman MINISH. I agree with you.

Mr. BARNARD. I think explore these profits because I think that while they are seemingly tremendous figures in dollars they are very small in terms of the percentage of total sales, which you people who are wise investors know is not very much. Your portfolio is, I am sure, very replete with stocks which are making a lot more than 2.98 percent profit of sales because otherwise you would sell your stock. I know you.

Chairman MINISH. I do not have any defense stock.

Mr. BARNARD. It does not have to be defense—anything.

Chairman MINISH. We are going to miss the vote. We are 8 minutes into the vote.

Mr. BARNARD. Always good to have you.

Chairman MINISH. I want to thank you very, very much.

Mr. BARNARD. I enjoy being with you on that side or this side.

Mr. GONZALEZ. Thank you very much.

Chairman MINISH. We will be back right after the vote.

[A brief recess was taken.]

Chairman MINISH. The subcommittee will be in order.

The next witness is the gentleman from Maryland, Mr. Parren Mitchell, a very valuable member of this subcommittee and a valuable member of the full committee and the House of Representatives. We are pleased, Mr. Mitchell, that you found time to come over here and give us your views on the pending legislation.

#### **STATEMENT OF HON. PARREN J. MITCHELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND**

Mr. MITCHELL. Thank you very much, Mr. Chairman.

It has been an honor for me to have served on the subcommittee that you chair since I have been in the Congress. We have done under your leadership many good things. I thank you for this opportunity to testify.

I would ask unanimous consent that my entire statement be submitted for the record and I would like to highlight certain points, if I may.

Chairman MINISH. Without objection.

Mr. MITCHELL. The chairman and the witness who just proceeded me have spoken about the huge military buildup in this Nation, the largest that we have ever experienced. Of this enormous sum that we intend to spend, \$175.3 billion, more than half will be used for the purchase of very sophisticated new weapons—approximately \$88.7 billion.

Because of the increasing demand for new technology and complex weapons—the MX, the Trident missile, B-1 bombers—we do not have any experience on which to base costs. Because costs are not negotiated in the military procurement process, sole source contracts are awarded most times.

Such negotiated prices are, by their very nature, based upon uncertain cost estimates because, as I indicated earlier, there is no track record. In effect, there is no experience on which we can actually base the cost. I would say that in the procurement of products similar to those traded in commercial markets, heavy Government spending can upset a cost-price relationship. We will spend heavily for the military this year and for the next 2 to 3 years.

That level of spending upsets cost-price relationships and, therefore, it reduces competition in the market. A number of defense contractors argue that competition for defense business is, in and of itself, an effective check on excess profits and, therefore, we do not need a renegotiation process nor a board.

The fact of the matter is that there is very little true competition in defense contracting. As the members of the subcommittee know,

most defense procurement occurs without competition. This is primarily because very few firms are able to raise the financial, engineering, and manufacturing resources necessary to perform multi-million dollar defense contracts. In the so-called competitive negotiated procurements contracts, technical or engineering factors rather than price may influence the award.

A number of other factors enter into it. The general lack of effective competition in the defense contracting business is reflected in the fact that the business is almost solely relegated to and controlled by 100 companies. It is the rare occasion when any other than the top 100 gets a multibillion-dollar contract.

Now I will be the first to admit that in many instances the top 100 will subcontract to smaller companies. But the ability to compete is limited primarily to the top 100 companies.

There are other persons who would oppose this legislation, contending that there is no need for renegotiation because cost accounting standards adequately protect the public against excessive profits. There are some protections. However, the standards do not determine what price the contractors will charge. We can set the standards but we cannot demand the price from a contractor. Because we cannot really set a price—and I do not think we should—it becomes exceedingly difficult to eliminate the possibility of excessive profits.

We have seen in recent years the enormous cost overruns in defense contracts. There was a \$2 billion cost overrun, 5 or 6 years ago, in the purchase of the Army cargo aircraft carriers. The San Diego Naval Shipyard is currently under investigation for a \$2 billion cost overrun on a contract. It is clear that without a Renegotiation Board, without a renegotiation process, it becomes much more difficult to control these enormous cost overruns.

I am not saying that the cost overruns occur because people are crooks or that they deliberately deceive or overprice. Any number of factors can enter into a cost overrun—a change in the volume of business, some unanticipated technological breakthrough while the contractor is in operation, a sharp change in the economic conditions. All of these factors might affect the cost of a contract.

However, when you encounter situations such as the one referred to in the GAO report where the actual profit rate on costs was 64 percent in one contract, rather than the negotiated rate of 11 percent, something is terribly wrong. We cannot have that kind of enormous profit-taking.

I will quote from the GAO report. It concluded:

Even assuming we had efficient and effective price negotiations for contract awards, we believe that renegotiation of actual profits realized is desirable to prevent excessive profits which result from changed conditions that cannot be anticipated at the time of contract award.

I supported the chairman in the past and I will do so in the future. We need a Renegotiation Board. We need a renegotiation process. And that is why I am fully supportive of H.R. 5651, which would institute the provisions of the Renegotiation Act of 1951 until September 1986.

One of the things I like most about this new piece of legislation is that it makes some very important amendments to the original law. Section 4, in particular—and I refer to that in my prepared

statement—would impose a requirement on contractors to report renegotiable business on the basis of division and product line. You simply cannot get any information with respect to the aggregates. It is just not feasible to do that.

I think that is a very good change. I honestly believe that this Nation is cheating itself when it does not have a Renegotiation Board and a renegotiation process. This is not to cast aspersions on defense contractors. This is not any attempt to smear a whole segment of our industrial society. But, rather, it is an attempt to do that which I think every Member of Congress would want to do—make sure we get the right thing at the right price under any contract.

That cannot be accomplished without the Renegotiation Board. I reiterate my support for H.R. 5651 and will be glad to entertain any questions that the chairman or members of the subcommittee might have.

[Mr. Mitchell's prepared statement follows:]

STATEMENT OF THE HONORABLE PARRIN J. MITCHELL (D-7TH-MD.) BEFORE THE SUB-COMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATIONS ON WEDNESDAY, AUGUST 4, 1982, 11:00 A.M., 2128 RAYBURN HOUSE OFFICE BUILDING

The Administration has committed this nation to the largest peace-time military buildup in history. On Thursday, July 29th, the House approved a \$175.3 billion defense authorization bill for next year. (The Senate has passed a bill to authorize \$177.9 billion for defense). This year's legislation represents a \$46 billion increase over the current year. More than half the money in the defense authorization is for the purchase of \$88.7 billion in sophisticated new weapons, while \$22 billion would go for research and development.

There will, as a result of this spending, be a continuing demand for new technology and increasingly complex aircraft (C5B cargo jets and B1 bombers), missiles (MX and Trident), space vehicles and other sophisticated production. Market-tested prices do not and cannot exist on such costly, complex and sophisticated military and space products. Prices, therefore, must be negotiated often (and, in the current military procurement process, the majority of the time) in a sole source environment.

Such negotiated prices are, by their very nature, based upon uncertain cost estimates because reliable cost experience is simply not available. Decades of experience have demonstrated that efforts to improve purchasing techniques and contract provisions cannot overcome the effects of these basic characteristics of military and space procurement in an age of advancing technology. But, even in the procurement of products similar to those traded in the commercial markets, heavy Government buying can upset cost-price relationships, thus rendering competition ineffective and creating conditions for the emergence of excessive profits.

Defense contractors argue that competition for defense business is an effective check on excessive profits; therefore the renegotiation process is unnecessary. But in fact, there is little true competition in defense work. Except for some common items such as food and clothing, most defense procurement occurs without competition. Few firms can muster the financial, engineering and manufacturing resources to perform multimillion dollar defense contracts.

Defense contract requirements for special equipment and expertise have effectively precluded competitors from entering the market.

For the so-called competitive negotiated procurements, technical or engineering factors rather than price may influence the award. Work load capacity or prior experience may provide one firm such an advantage that others cannot effectively compete. In these circumstances, the fact that one bidder quotes a lower price than the others is not assurance against excessive profits.

The general lack of effective competition in defense contracting is further evidenced by the high concentration of defense business in a few large defense contractors. For many years, over two thirds of the annual defense business has gone to only 100 companies.

Some contend that there is no need for renegotiation on the basis that cost accounting standards adequately protect the public against excessive profits. Unfortunately, this is not necessarily the case. Cost accounting standards provide greater consistency in cost accounting for defense contracts and establish a common basis for measuring costs and profits. However, these standards do not determine what prices contractors charge and, therefore, do not preclude excessive profits.

Excessive profits are not necessarily the result of deception or deliberate over-pricing. Unexpected changes in volume of business, unanticipated technological breakthroughs in the industry, a sharp change in economic conditions, or honest errors can all lead to excessive profits despite compliance with all existing procurement regulations. For example, a 1975 GAO study on the causes of excessive profits cites a case wherein the contractor realized an actual profit rate on costs of 64 percent rather than the negotiated rate of 11 percent. The GAO concluded: "Even assuming we had efficient and effective price negotiations for contract awards, we believe that renegotiation of actual profits realized is desirable to prevent excessive profits which result from changed conditions that cannot be anticipated at the time of contract award.

The acceptance of contractors' reports at face value is a shortcoming of the procurement process. Cost and profit figures reported by contractors are often far different from the actual figures determined by Government audit. In 1971, the GAO conducted an audit of 146 specific contracts which showed profits to be much higher than the overall defense profits reported by contractors. When the Renegotiation Board was in operation its audits resulted in substantial adjustments to figures reported by contractors. The Board analyzed 800 filings processed in fiscal year 1970 by the regional board's accounting divisions and found that the contractors' reported profits required a net upward adjustment of \$191 million, or 27 percent more profits than the contractors had originally reported. The Board found that expenses applicable to contractors' non-renegotiable businesses were being charged to renegotiable business; exemptions from renegotiations were claimed for certain sales that

were not entitled to exemption under the Act; and costs applicable to renegotiable sales were reported without reporting all revenues related to such costs.

H.R. 5651 would reinstitute the provisions of the Renegotiation Act of 1951 until September 30, 1986. It would, however, make some very important amendments to the original law. Section 4, in particular, would impose a requirement upon contractors to report renegotiable business on the basis of a division and product line. The original language of the 1951 Act specified that renegotiation be conducted on the basis of the total, aggregate, renegotiable sales of a contractor in a fiscal year. This procedure permits contractors with renegotiable sales in unrelated product lines to offset excessive profits on one product line with low profits on other unrelated product lines. Such offsets are economically unsound, and as a matter of public policy not in the national interest. Renegotiation is predicated on the fact that in the Defense purchasing procedure, excessive or windfall profits may arise. With this in mind, there is no justification for permitting an offsetting of such unearned income with low profits on other unrelated product lines. The renegotiation practice of permitting offsets of profits between unrelated product lines discriminates against the smaller contractor in favor of the large diversified contractor. In practice it amounts to encouraging the larger contractors to underbid smaller competitors in unrelated product lines.

Chairman MINISH. Thank you, Mr. Mitchell, for a very excellent statement.

Mr. Annunzio?

Mr. ANNUNZIO. I thank you, Mr. Chairman.

I commend the watchdog of small business in America for his very excellent statement. You have adequately outlined the great need for a board and I concur with your thoughts. I think that defense contractors have nothing to fear, because all of us want an adequate defense of our Nation, which is of primary importance. But we all want to watch the tax dollar and, as you so adequately put it, we want to be sure that the dollars are being spent in the right direction.

So I commend you, my colleague, for your very excellent statement on the legislation.

Mr. MITCHELL. Thank you.

Chairman MINISH. Mr. Parris.

Mr. PARRIS. Thank you, Mr. Chairman.

I very much enjoyed your comments, Mr. Mitchell, and let me just pose one very brief question to you.

Everybody, I think all the members of this subcommittee and Members of the Congress and every taxpayer in America would abhor cost overruns as undesirable and sometimes certainly questionable. This building, if memory serves, in which we sit had a cost overrun of some \$400 million or something in that range. It was outrageous.

Yet we currently have Renegotiation Board functions which have been replaced by a number of auditing programs which presumably safeguard the defense procurement process—the Defense Contract Audit Agency, the Truth in Negotiation Act, the Armed Services Procurement Regulations, the CASB, and so forth.

My real question to you is, Is it your real belief—and I do not mean that in the sense that you are not sincere in what you said, but do you truly believe that this agency's functions have not been appropriately absorbed by other existing agencies and are we not perhaps considering the reestablishment of a redundant agency?

Mr. MITCHELL. I do not believe that we are about to do something that would be redundant. The problem that took place where other agencies took on the job that had been done by the renegotiation board was that they used cost accounting procedures.

A contractor can contend that the fair contract price is \$4 million. The agencies simply keep reviewing to see whether they are staying in line in terms of cost accounting practices and will, of course, if justified, say sure it can be increased to \$4.5 million.

The Renegotiation Board would deal with the actual price that it was charged. There is a world of difference between those two approaches. A contractor can say my price is \$8 million and the only method of verification is the cost accounting system. The Renegotiation Board can say oh, no. The fair, legitimate price should have been \$6 million. That is why I do not think the proposed bill is redundant.

Chairman MINISH. Would the gentleman yield?

Mr. PARRIS. Certainly.

Chairman MINISH. No one took over the responsibility of watching over the profits made on defense contracts once the Renegoti-

ation Board closed its doors. Nobody took up the duties, to my knowledge.

Mr. MITCHELL. It is merely cost accounting. It is not determining a fair price for the product.

Mr. PARRIS. I have been informed that the GAO estimated in 1977 that the Government was spending something in the vicinity of \$8 billion a year for 54,000 employees to supervise procurement and contractors' performance in compliance with standards.

If I am also reliably informed—and I think I am—that the Renegotiation Board found "excessive profits" during its last year in operation of \$82 million, now if we are spending \$1 billion already and employing in excess of 54,000 employees for that purpose, can we not fold this function into existing agencies in some way?

Mr. MITCHELL. I am afraid we simply cannot do that. The amount that is being spent is across a broad array of activities in defense.

I think we are spending too much money there and probably have too many people, but there is simply no way because of the nature of the defense industry that the work of the Renegotiation Board can be eliminated.

I am not naive. I know that there is a relationship—and I will use that in quotes—between the defense industry and the Department of Defense. There has to be a relationship. I will not attempt to describe what kind of relationship that is, but it is obvious that this nexing will prevent any of these agencies located within the Department of Defense from doing the kind of job that a Renegotiation Board would do.

Mr. PARRIS. Thank you.

Chairman MINISH. Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman.

Today we have a very able witness for this bill in the distinguished member of the Banking Committee, Chairman Parren Mitchell. Certainly he has made a very well-documented statement about his concern for renewal of the Renegotiation Committee.

As Mr. Parris has said, no Member of Congress wants to see this Government taken advantage of, especially from the standpoint of defense contracts. I think the consideration of this bill reflects concern for that.

But the thing that I would bring to my distinguished friend's attention is the fact that we have put into place extensive procurement practices that would seemingly to me, as a former businessman, pretty well determine that excess profits would not develop.

I would just like to show you this document. This one little column right here on this first page indicates all of the procurement practices that existed in 1951. On the opposite side of the page are what procurement practices were in 1976—two full pages of requirements which cover everything—the cost of money, pension cost, cost accounting periods.

We have put into practice a very extensive procurement operation which in itself is very costly for any contractor who wants to bid on a Government contract. You do not feel that would be sufficient to offset any problem of excess profits?

Mr. MITCHELL. No, I do not, and I am familiar with the document that you just had in your hand.

I have to make almost the same statement to you that I made to Congressman Parris. All of those activities do not in any way relate to the price that the contractor offered—fair, just, equitable. All of those agencies address cost after the fact. After the price has been set, then the agency will monitor the implementation of that contract. The bulk of them do that.

There are certain requirements that come in advance. I would be the first to admit that. But, Mr. Barnard, let me tell you one other curious thing that has happened that I think points to the necessity for a Renegotiation Board.

A subcommittee of the House Armed Services Committee is now or will shortly be conducting an investigation into the lobbying activities of the Department of Defense on behalf of certain private sector industries. The discussion that took place on the floor clearly pointed out that DOD had some of its employees writing letters on behalf of one aircraft manufacturer. There were ads printed at the expense of the Department of Defense.

These are the allegations—and they are serious enough to be taken up by a subcommittee of the House Armed Services Committee. With the enormous amount of money that we are spending and the renewed zeal of DOD, it is obvious that they are not going to quibble about price.

I will not cite the gentleman's name because I do not want to be unfair to him, but I will tell you in all honesty and candor I experienced this. A man came in to me and asked me to help him get a Government contract—an Army contract. He had been working on it for 2 years. He finally came in a couple of months ago and said I got the contract at a higher price than I had offered.

I said well, how did you manage to do that? I had been working with a major in DOD trying to implement the contract. My person said to me a colonel reviewed it and said go ahead, let him have the contract. We have got more money than we can actually spend.

Now I will not call my constituent's name. I will swear to you on a stack of Bibles that that conversation took place in my office between me and the person who got the contract.

In that kind of climate it just seems to me imperative that we look at the matter of price.

Mr. BARNARD. How could that situation be corrected with the Renegotiation Board?

Mr. MITCHELL. They look at price. They look at the price of the contract from the very outset.

Mr. BARNARD. But isn't most of it on a bid basis?

Chairman MINISH. Will the gentleman yield?

Mr. BARNARD. Sure.

Chairman MINISH. The way the Renegotiation Board would deal with this is once the contract was complete, they would examine the final costs and money spent to determine whether there were excessive profits.

Mr. BARNARD. All right. Now I would like to ask this question. I realize my time is up.

Mr. MITCHELL. Could I point out one other thing too? Most of it, as you know, is done on a nonnegotiated basis.

Chairman MINISH. Well, of course approximately 60 percent.

Mr. BARNARD. We have already corrected that in the law. In the law. There is a statute which says profit on cost plus fixed-fee contracts cannot be more than 10 percent. We have got that already in the law.

Mr. MITCHELL. Yet the GAO report shows that under the law a company came up with a 64 percent profit.

Mr. BARNARD. One case, though.

Mr. MITCHELL. Well——

Mr. BARNARD. One case. I do not know whether they were selling peanuts, popcorn, or what they were selling. We have got to document that. I think that that is worth citing as an example, but I think it ought to be——

Chairman MINISH. If the gentleman would yield, the GAO representatives are here.

Mr. BARNARD. Well, we will ask them about it and I respect my distinguished friend and chairman for including it in his testimony. But I would like to know who that was.

Now, getting back to the petition for an inquiry which was given great notice yesterday on the floor and then which was referred back to the committee, I think that is an issue beyond what this committee needs to be taking up this morning, but it is very worthwhile.

What in your opinion are "excessive profits?"

Mr. MITCHELL. I would not have the temerity to give a definition for "excessive profits." That is the function of the Board. That is the function, to look at what is customary in that industry, where the economy is at a given point, and then determine what might be excessive profits.

May I add, Mr. Barnard, the fact that we are looking at a \$2 billion cost overrun at the San Diego Naval Shipyard which implies that somebody somewhere has a definition of excessive profits.

Chairman MINISH. The time of the gentleman has expired.

Mr. Weber.

Mr. WEBER. Thank you, Mr. Chairman.

I am a newcomer to this Congress and I do not begin to understand the procurement process. I have to admit a healthy degree of skepticism about reactivating the Renegotiation Board simply because I can recall as a lay person, when this Board was defunded, there was one thing that stood out in my mind.

The Board cost more to operate than the money that had been recovered for the benefit of the taxpayers of the country. That is the fact that stands out. I would be glad to take responses from both of you.

Chairman MINISH. I can tell you right now your impressions do not reflect the true value of the Board. I can give you correct figures.

Mr. MITCHELL. I have seen that allegation booted about time and time again, and nowhere have I seen any evidence of the fact on which the allegation is based. It is simply not true.

What happened, Mr. Weber, to the best of my recollection, is that at a given point in time the defense industries simply decided that they wanted as much latitude as possible, so they went on a sustained campaign against the Renegotiation Board and won. At the same time, we had the Joint Defense Production Committee, on

which I had the honor to serve—Senate-House Committee—and they went after that committee too, and that committee was abolished. It was simply not funded again by the House Administration.

This was a long-term effort on the part of the defense industry to get rid of two thorns in their side—the Renegotiation Board and the Joint Committee on Defense Production.

Mr. BARNARD. Would the gentleman yield?

Mr. WEBER. I would be glad to yield.

Mr. BARNARD. Since you brought that point up, let me clarify it. In the previous consideration of this subject, when the Renegotiation Committee was not reextended, the testimony is replete that it cost \$10 for every \$1 that was brought back in. Of course, everybody figures cost a different way.

Now my distinguished chairman is going to say that is wrong.

Chairman MINISH. If you will yield—

Mr. BARNARD. I will not yield. I am not finished. But the cost he is going to talk about is only cost to the Government. That is not the basic true cost. You have got to consider in the cost what it cost industry to comply and if you take the Government's expense of running the Renegotiation Board plus the cost of industry to comply with this unnecessary activity, it cost \$10 for every \$1 that the Government collected.

Mr. WEBER. I would be happy to yield to the chairman.

Chairman MINISH. First of all, the last year that the Board was in effect they spent \$6 million. Now that is the cost of the Board.

Mr. BARNARD. That is right.

Chairman MINISH. The subject that my dear friend from Georgia brings up is the cost to industry. We have in the files one of the magazines that is used by industry where in one story they give three different figures. They go anywhere from \$35 million up to \$270 million. The truth of the matter is all that industry fills out is one simple sheet. I think it is RB-52, if that is the number. That is what industry claims is overburdensome.

Mr. BARNARD. But, Mr. Chairman, you just do not get those figures out of thin air. Have you thought about the staff and the computers and all of the other necessary things to get that one little piece of paper? I guarantee if you figured the cost it cost you to fill out your 1040 form, we are not talking but 2 seconds. But you have got to keep records to do that.

I mean, you have got to be fair in telling what the cost is, and the cost is not just what it cost us to fund the Renegotiation Board. We have got to go beyond that because that is part of the necessary gross national product.

Chairman MINISH. We can get some information on that from the GAO.

Mr. WEBER. Let me reclaim my time from the chairman.

There is one other reaction that I am receiving more and more and hearing more and more from businesses which are trying to deal with the U.S. Government. That is the fact that they are getting fed up with the runaround and redtape and more and more businessmen are telling me it is not worth it to me to try to do business with the Federal Government, which means that we are

having fewer and fewer people in the process of competing for Government business.

I am not sure that this is a healthy sign and I am not sure whether revising the Renegotiation Board is going to have a further detrimental effect on the number of businesses that wish to compete for Government business or not. I would think that would have a chilling effect on some of those businesses.

Mr. MITCHELL. I spoke earlier about the defense contractor complex, the same 100 firms. I have heard them yell and scream about too many requirements, too many regulations and so forth. But I have yet to see one of that top 100 say I do not want a contract. It is too troublesome to me—not a single one. I have heard similar arguments from medium-sized firms, not the giants. And yet they continue to assiduously pursue Government work.

The only group that really has backed off completely are small businesses. They just do not have the staff, time or expertise to follow the maze of regulations and requirements. They are the ones that are hurting, not the medium-sized businesses and not the giant corporations.

Mr. WEBER. Thank you.

Chairman MINISH. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Mitchell, you are a champion of small business. In terms of these alleged excessive profits in the defense industry, are they being made by big businesses or small businesses? I might ask a followup question to that: How do the small businesses of this country feel about complying with the greater burden of paperwork to meet the requirements the Renegotiation Board would have?

Mr. MITCHELL. The requirements of the Renegotiation Board, just those requirements, are not that complex, as I recall. They are relatively easy to meet. The fact of the matter is, though, that very few small businesses are getting Government contracts—certainly defense contracts.

We on the committee and on the Small Business Committee have argued for years. You take a \$30 million defense contract and break it down into smaller components that can be managed by small businesses and that is equitable.

But there has been enormous resistance on the part of the Department of Defense to break down these contracts so that small businesses can compete. I would hope that we will keep plugging away at it. I would hope that we would get a greater share of Government contracts across the board for small business. The resistance still remains very great.

Mr. WORTLEY. You think small business wants to comply with all that paperwork?

Mr. MITCHELL. Your question was the requirements imposed by the Renegotiation Board. I pointed out that those are not very complex requirements. I do not think anyone wants to go through the problem of wrestling with all of the paperwork requirements by DOD or anybody else. I think we need to simplify them.

But the bottom line—and I will say it again and again and again—is the price for the product or the service rendered fair. Right now we have no way, no sure way, of checking on the fair-

ness of it. I do not care if it is a small business or giant corporation. We have got to make sure that the price is fair.

Mr. WORTLEY. According to a former Renegotiation Board member who testified before this subcommittee last year, excess profits from 1956 to 1976 ranged somewhere between \$8 million and \$70 million. That is quite a broad range. He also said that the cost of complying, fulfilling the accounting procedures and records that were necessary, averaged about \$100 million a year.

There is no cost-effectiveness to this. How do you expect to address that problem so we are assured that it is cost-effective?

Mr. MITCHELL. The key is who gets named to that Board. Are they going to be people who will really zealously pursue their duties? This came up in several meetings of the subcommittee where we found members of the Board who were in a position where they simply did not want to vigorously pursue the matter of determining whether the cost was fair.

I recall in one meeting of the subcommittee where it was made very clear to us that the Board members, some of them, had made a decision not to pursue the giant corporations. They went after the smaller businesses with high costs. They became the targets.

It is because there was a bad Board in part. Some of them were excellent members. However, some of them were simply there to protect the defense industry against any possible allegation that the price had not been fair. The key is who gets appointed to that Board.

Mr. WORTLEY. I think it would be a shame if the same type of people were on the board and they were going after small businesses. Small business in this country has enough problems.

Mr. MITCHELL. I think it would be heinous to appoint that type person to the Board.

Mr. WORTLEY. Well, that is the past track record.

Mr. MITCHELL. And that is the fault of the political process.

Chairman MINISH. May I make two comments in light of what you covered? Two years ago we had a study made on small business.

Increasing the threshold to \$5 million from \$1 million would eliminate 60 percent of small business even from getting involved. The threshold was \$1 million. This legislation would increase it to \$5 million.

Now the other question involves the cost to industry. When I hear this issue raised, the implication is that this law would require contractors to keep records in far greater detail than they otherwise would. I would assume that they do their own accounting. If they keep records, what is wrong with giving those records to the Government when they ask for them? That is all we are looking to accomplish through renegotiation.

Mr. WORTLEY. But, Mr. Chairman, a small tool company that is working at a number of jobs at the same time, of which their government contract is only one job in the shop, it is pretty difficult sometimes to break down how much energy, how much power, how much heat.

Chairman MINISH. Well, if he is a subcontractor, he is not as involved as the major contractor, and would most likely be exempt under this bill.

Mr. WORTLEY. Thank you, Mr. Chairman.

Chairman MINISH. Thank you very much, Mr. Mitchell, for a very excellent statement.

Mr. MITCHELL. Thank you for the opportunity to appear before you.

Chairman MINISH. Mr. McCloskey. I want to say that some of the things you are going to say have been preempted by some of the statements up here already. You can proceed.

**STATEMENT OF HON. PAUL N. McCLOSKEY, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA**

Mr. McCLOSKEY. Thank you, Mr. Chairman. I think everyone has my written testimony in front of them if I may ask consent that it be submitted for the record at this time.

Chairman MINISH. Without objection.

Mr. McCLOSKEY. I would like to just touch on three parts of the testimony. If you will look at the last 3 pages—and I wish Mr. Mitchell might stay to examine those 3 pages—it will show you that in the last three years of the Renegotiation Board's operations—1976, 1977, and 1978—that over 4,500 companies filed reports each year and in 1976, 46 companies were assessed excess profits, 37 in 1977, and 37 in 1978. You will look in vain for a large company on that list. There is no McDonnell Douglas. There is no Lockheed.

I would like to add to the written testimony that I gave. Our staff ran a survey of what would have been happening in those 3 years if we accepted the committee's bill with the \$5 million floor and used the 15-percent profit ceiling as was in the Patterson bill offered in the last Congress.

Under those figures, if you assess profits only above 15 percent and only companies doing more than \$5 million in sales, you averaged out roughly \$6.4 million a year in return to the Government against an admitted cost of the agency of \$5.5 million a year.

Now note also the testimony of a former Director of the Renegotiation Board's operations. He was Director until June of 1977, when he joined Touche Ross. His name is Donald S. Grenough.

Mr. Grenough testified before the House Armed Services Procurement Subcommittee on June 18, 1981. It was his estimate that the annual cost of renegotiation, to industry and thus to the Government, was at least \$110 million.

The final point I wanted to add to my prepared statement is on a specific case which was drawn to my attention and which caused me to work for about 3 years to abolish the Renegotiation Board. This was the case of the A. C. Ball Co., a small tool company in my own district, one of those against whom excess profits were ascertained at \$250,000. The company took it up on appeal, as about half of the companies who have been reassessed have, and in the appellate process the court cut the amount of excess profits from \$250,000 to \$50,000.

Yet the total legal costs and witness costs for the company in the litigation exceeded the \$50,000 and, knowing how the Government operates, I can only assume that in the Justice Department or

whomever was representing the Government's case, the cost also exceeded \$50,000.

Now I have no quarrel with the concept of renegotiation in time of war, when contracts are executed under emergency conditions. I at one time served in the Marine Corps in Korea in the early days of the Korean war, and the fact that we did not have thermal boots caused a lot of Marines to suffer frostbite. There is no question that under the emergency conditions in 1950 and 1951 there was a justification for immediate ordering of goods on which excess profits might be levied.

In 1951, the Congress renewed the Renegotiation Act, but we have added a provision to current law that, in the event war occurs, permits a reinstitution of a process to renegotiate excess profits. It seems to me that is enough.

I will cease at that point, Mr. Chairman. You and I have discussed this on many occasions.

[Mr. McCloskey's prepared statement follows:]

Statement of  
Hon. Paul N. McCloskey, Jr.  
before the  
Banking Committee, Subcommittee on  
General Oversight & Renegotiation  
August 4, 1982

Mr. Chairman:

As a majority of the House agreed in 1979, the Renegotiation Board, as it then existed and operated, was not of benefit to the nation. The key House action, a letter to Appropriations Subcommittee Chairman John Slack, signed by 224 House Members, is appended to this testimony. That letter was delivered on March 21; on Wednesday, May 28, the House terminated funding for the Board and it passed out of existence on March 31, 1979.

I would not oppose the existence of a renegotiation mechanism in time of war or national emergency when the Government's needs are immediate and make arms length bargaining difficult. In peacetime, however, I believe the Renegotiation Act became both superfluous and counterproductive.

The original Renegotiation Act had its genesis in 1942, a time of grave national emergency -- when contracts had to be negotiated under stress and in great haste -- when the Government's immediate need for services and materials transcended all other considerations. Under these circumstances, renegotiation to recover excess profits was justified and necessary.

The same circumstances existed in 1951 when the present act was enacted. As in 1942, we were in the first year of a major war. Contracts were being executed under special emergency circumstances, and a special law to balance the equities between the parties was clearly in order.

Today, however, there is no such urgency. Government procurement officers are experienced, competent and under law, if

if any, time pressures. The principles of contract law are rooted deep in our history, and are well understood by the most recent law school graduates. The need to renegotiate a contract is a concept which should have no place in a society where the contracting parties can meet, in dispassionate and quiet negotiations, with neither party under pressure to make or accept an offer.

Since 1951, Congress has enacted a whole series of additional laws calculated to protect against excess profits. The Truth in Negotiations Act (P.L. 87-653), Cost Accounting Standards (P.L. 91-379) and the Defense Acquisition Regulations (32 C.F.R. Section XV) all operate in favor of the Government to require fair negotiating and fair reporting by contractors. Under these statutes, the Government can require a contractor to provide all relevant cost data, define the costs it will and will not pay, require the contractor to negotiate on the basis of that data, control the method used by the contractor to estimate and accumulate costs, and audit all records related to those estimates or to actual costs. No government representative can legally waive these protective devices.

Furthermore, in the unlikely event that excessive profits occur, the defective pricing provisions of the Truth in Negotiations Act can be used as a profit-limiting device as was demonstrated by the experience of the Navy during the Vietnam War. The Navy's audits indicated that all their bomb body contracts were generating excessive profits. Using the defective pricing provisions, the Navy went back to the four contractors supplying the bomb bodies and reduced their profits.

8

Thus, aside from emergency procurement situations, i.e., wartime, sudden mobilization requirements, etc., there is no need for a renegotiation process. The best means to handle situations where the Government fears an excess profit is to write into Request for Proposals and procurement contracts a provision that the contractor will return any profit in excess of a given percentage stated by the Government. The percentage figure could be that customarily reflected in the industry or by the contractor in question, or it could be a different figure.

In emergency situations, the Vinson-Trammell Act, as amended by the House Armed Services Committee last year (10 U.S.C. section 2382), instructs the President to establish profit controls during wartime or national emergency.

Why, then, should there be a special law, in nonemergency circumstances to give the Government a special remedy?

What showing has any witness made before the House committees of jurisdiction that any contract executed by the Government under peacetime conditions, where the contractor complied with all of these laws to protect the Government, resulted in inordinate profits to the contractor?

From the Renegotiation Board's last report, of December 31, 1976, it appears that in 1976 some 4,559 contractors filed with the Board. Forty-six contractors--about 1 percent--were determined to have made excessive profits. Of the 4,559 filings, 2,511 were screened, representing \$24 billion in renegotiable sales.

Of this \$24 billion, the Board determined that there were excess profits of slightly over \$40 million. Assuming a 10-percent reasonable profit--one measure used by the Maritime Administration, for example--if one were to assume that \$24 billion in sales allowed \$2.4 billion in acceptable profits, only \$40 million, or approximately 1 1/2 percent of the total allowable profits, were found by the Board to be excessive.

And what were the costs to the taxpayer for this \$40 million potential recovery?

First, the cost of the Board's operations for fiscal 1976 were approximately \$5.5 million.

Second, the loss in corporate income taxes to the Government would be approximately half of the \$40 million reduction in profits, an additional \$20 million.

Third, there is the cost to the contractor -- passed on to the Government -- of compliance with the act itself. One company in my congressional district, Hewlett-Packard, estimated that the cost of compliance with the act in 1976 came to \$197,000. The company's total renegotiable sales totaled approximately \$30 million, pegging this cost of compliance at about 7/10 of 1 percent of renegotiable sales. If the same percentage is applied to total national renegotiable sales of \$24 billion, cost of compliance to industry could be roughly \$168 million annually.

Thus, using Hewlett-Packard's estimate, the net cost of the Renegotiation Board to the American taxpayer was roughly \$160 million in 1976.

Last year, the former Director of Operations of the Renegotiation Board, Donald Grenough, testified before the House Armed Services Committee, and estimated the net cost of his former employer at \$110 million. His precise words follow:

"Exclusive of excess profit determinations applicable to the Korean War, which were in excess of \$100 million per year, excess profit amounts determined by the Board during the last 20 years of its existence ranged from \$3 to \$70 million annually and averaged about \$30 million per year. Contractor appeals to the courts historically have reduced the recoverable amount by 20%. Excessive profits were determined by the Board to be present mostly in other than very large companies; for example, during the 5 year period 1974-1978 only about 7% of the excess profit cases involved companies with renegotiable sales in excess of \$100 million annually...

"I believe that maintaining accounting records, performing special analyses, and preparing the filings cost at least an average of \$20,000 per company, or a total of at least \$100 million per year. When the additional costs of renegotiation are included such as Board operations of about \$4 million per year, requests for additional information by the Board, conferences, legal and accounting fees, and Justice Department expenses, the minimum annual cost of renegotiation would be at least \$110 million. When this amount is compared with the \$30 million of excessive profit determinations described above, the cost/benefit value of excess profit legislation during the past 20 years becomes highly suspect." (emphasis added)

If our colleagues will look at the list of 120 companies found by the Board to have made excessive profits during the three-year period of 1976 through 1978, the Renegotiation Board begins to look more like an anti-small business act than a law to deny excessive profits to large corporations.

None of the 120 companies exceeded \$270 million in annual renegotiable sales. A list of these companies is attached, and you will look in vain to find any household name of the defense industry.

I would like to make particular reference to a case involving a constituent of mine, the A.C. Ball Corporation of San Carlos, California, a small manufacturer of wheels and screws. The Renegotiation Board determined that A.C. Ball had made \$250,000 in excess profits in 1967. A.C. Ball appealed the Board's decision and in 1976 the Court of Claims ruled that A.C. Ball had made only \$50,852 in excess profits, a reduction of nearly \$200,000, or 80%, from the Renegotiation Board's initial decision. Assuming that A.C. Ball's litigation expenses and legal fees exceeded \$51,000, and that the Government's expenses did likewise, the Government actually suffered a net loss in this case.

The General Accounting Office has studied all the appeals before the U.S. Court of Claims from 1974 to 1992, and has found that the Renegotiation Board's assessments were reduced by 39% through the appeal process over this nine-year period. It seems highly likely that the Government's litigation costs exceeded the amounts actually recovered during this period.

On three separate occasions during the past seven years Congress has rejected the concept of contract renegotiation during peacetime: in September, 1976, when Congress refused to extend the Renegotiation Act; in March, 1979, when the Board's funding was finally terminated; and in July, 1981, when Congress repealed the Vinson-Trammell Act, the 1934 profit-limitation law which became effective upon expiration of the Renegotiation Act, save in wartime or a national emergency.

I hope the committee will exercise similar judgment by opposing any new attempt to resurrect the Renegotiation Board, including the bill before you today, H.R. 5651.

PAUL N. McCLOSKEY, JR.  
12th District, California

COMMITTEE ON  
GOVERNMENT OPERATIONS  
AND  
COMMITTEE ON  
MERCHANT MARINE  
AND FISHERIES

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Washington, D.C. 20515

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Honorable John Slack, Chairman  
Subcommittee on State, Justice,  
Commerce and Judiciary  
Committee on Appropriations  
1536 Longworth Building  
Washington, DC 20515

Dear John:

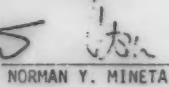
Last year under your leadership, we voted to abolish the Renegotiation Board, effective March 31, 1979. This was the first time in 22 years that Congress had abolished a government agency. The decision was made following lengthy hearings on the Board's record, which showed that the Board's paperwork resulted in only a minor benefit (net: \$3½ million) to the government, but imposed a major burden (in excess of \$200 million) upon the businesses involved.

The agency refuses to die, however. Despite a clear congressional mandate that it cease operations on March 31, as of today the Board still has not adopted a phase-out plan, and instead, has prevailed upon the Administration to present a supplemental appropriation bill to continue funding its operations.

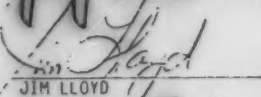
We ask that your Appropriations Subcommittee do what it did last year and deny funding for operations after March 31. A fact sheet covering the Board's activities is enclosed for your review.

Respectfully,

  
JERRY M. PATTERSON

  
NORMAN Y. MINETA

  
PAUL N. McCLOSKEY, JR.

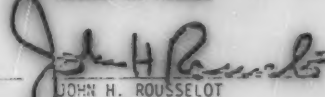
  
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| <i>Adam Benjamin</i><br>ADAM BENJAMIN           | <i>Ray Kogovsek</i><br>RAY KOGOVSEK         | <i>Mike Mc Cormack</i><br>MIKE MC CORMACK |
| <i>Jack Brinkley</i><br>JACK BRINKLEY           | <i>Bill D. Burlison</i><br>BILL D. BURLISON | <i>David E. Senior</i><br>DAVID E. SENIOR |
| <i>Sam Hall</i><br>SAM HALL                     | <i>Eugene Atkinson</i><br>EUGENE ATKINSON   | <i>Ike Skeilton</i><br>IKE SKEILTON       |
| <i>Jerome Ambro</i><br>JEROME AMBRO             | <i>Ed Beard</i><br>ED BEARD                 | <i>Gunn Mc Kay</i><br>GUNN MC KAY         |
| <i>Austin Murphy</i><br>AUSTIN MURPHY           | <i>Andy Ireland</i><br>ANDY IRELAND         | <i>Jim Oeffstar</i><br>JAMES OEFFSTAR     |
| <i>Walter Jones</i><br>WALTER JONES             | <i>Bill Nelson</i><br>BILL NELSON           | <i>Mike Synar</i><br>MICHAEL SYNAR        |
| <i>Charles Whitley</i><br>CHARLES WHITLEY       | <i>Romano Mazzoli</i><br>ROMANO MAZZOLI     | <i>Wyche Fowler</i><br>WYCHE FOWLER       |
| <i>Earl Hutto</i><br>EARL HUTTO                 | <i>Vito Fazio</i><br>VITO FAZIO             | <i>Jim Mattox</i><br>JIM MATTOX           |
| <i>Robert Davis</i><br>ROBERT DAVIS             | <i>Peter Peyser</i><br>PETER PEYSER         | <i>James Abdnor</i><br>JAMES ABDNOR       |
| <i>Lionel Van Deeplin</i><br>LIONEL VAN DEEPLIN | <i>Dan Marriott</i><br>DAN MARRIOTT         | <i>Joe Wyatt</i><br>JOE WYATT             |

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*James Sensespinner, Jr.*  
JAMES SENSESPINNER, JR.     *Samuel L. Devine*  
SAMUEL L. DEVINE     *Francis J. Brown*  
FRANCIS J. BROWN

*William Brookfield*  
WILLIAM BROOKFIELD     *Tim Lee Carter*  
TIM LEE CARTER     *Douglas Bersuter*  
DOUGLAS BERSUTER

*Toby Roth*  
TOBY ROTH     *W. Benson Moore*  
W. BENSON MOORE     *Arlen Erhardt*  
ARLEN ERHARDT

*David C. Tamen*  
DAVID C. TAMEN     *Gene Snader*  
GENE SNADER     *Don Hinson*  
DON HINSON

*Margaret Smith*  
MARGARET SMITH     *John Paul Hammerschmidt*  
JOHN PAUL HAMMERSCHMIDT     *Bill Archer*  
BILL ARCHER

*Ken Framer*  
KEN FRAMER     *Ed Bethune*  
ED BETHUNE     *Ron Marlenee*  
RON MARLENEE

*Gerald Solomon*  
GERALD SOLOMON     *Carroll Campbell*  
CARROLL CAMPBELL     *John W. Wydler*  
JOHN W. WYDLER

*Ed Forsythe*  
ED FORSYTHE     *James Courter*  
JAMES COURTER     *Millicent Fenwick*  
MILLCENT FENWICK

*Larry D. Hopkins*  
LARRY D. HOPKINS     *Mark Andrews*  
MARK ANDREWS     *Nent Hance*  
NENT HANCE

*James L. Devine*

*James L. Devine*  
JAMES L. DEVINE

EXCERPTS: RENEGOTIATION BOARD ANNUAL REPORTS 1976-1978

1976 Renegotiation Board Annual Report

TABLE I—Contractors

FY 1976

| No. | Name                                                                               | Address                 | Fiscal Year | Product or Service         | SIC No. |
|-----|------------------------------------------------------------------------------------|-------------------------|-------------|----------------------------|---------|
| 1.  | Commerce Packaging Corp.                                                           | Stamford, Conn.         | 1968        | Packaging service          | 7399    |
| 2.  | Terry Corporation of Conn.                                                         | Windsor, Conn.          | 1971        | Steam turbines             | 3511    |
| 3.  | Pacific Architects & Engineers, Inc.                                               | Los Angeles, Calif.     | 1967        | Facilities management      | 7399    |
| 4.  | Chamberlain Manufacturing Corporation                                              | Elmhurst, Ill.          | 1968        | Govt. Plant Operations     | 3901    |
| 5.  | Chamberlain Manufacturing Corporation                                              | Elmhurst, Ill.          | 1969        | Govt. Plant Operations     | 3901    |
| 6.  | Horne Brothers, Inc.                                                               | Newport News, Va.       | 1967        | Ship conversion & repair   | 3731    |
| 7.  | Horne Brothers, Inc.                                                               | Newport News, Va.       | 1968        | Ship conversion & repair   | 3731    |
| 8.  | Mechanical Piping, Incorporated                                                    | Newport News, Va.       | 1968        | Pump & valve distr.        | 5084    |
| 9.  | Mechanical Piping, Incorporated                                                    | Newport News, Va.       | 1970        | Pump & valve distr.        | 5084    |
| 10. | Norris Industries, Inc.                                                            | Los Angeles, Calif.     | 1969        | Bomb & cartridge cases     | 3483    |
| 11. | Air Burner Controls, Inc.                                                          | Glendale, Calif.        | 1973        | Harness assemblies         | 3679    |
| 12. | Dilettia Corporation                                                               | Farmingdale, N.Y.       | 1973        | Teflon & rubber containers | 3079    |
| 13. | Trustee to Keystone Micro-Scan Inc., SII to<br>Keystone Bay State Industries, Inc. | Boston, Mass.           | 1969        | Fuses                      | 3483    |
| 14. | Republic Corporation SII to Polan<br>Industries, Inc.                              | Century City, Calif.    | 1968        | Periscopes & weapon sights | 3483    |
| 15. | Met-Pro Water Treatment Corp.                                                      | Lansdale, Pa.           | 1970        | Water purification systems | 3589    |
| 16. | Met-Pro Water Treatment Corp.                                                      | Lansdale, Pa.           | 1971        | Water purification systems | 3589    |
| 17. | Bannercraft Clothing Company, Inc.                                                 | Philadelphia, Pa.       | 1968        | Military coats             | 2311    |
| 18. | E. Walters & Company, Inc.                                                         | Elk Grove Village, Ill. | 1970        | Fuse parts                 | 3483    |
| 19. | MJM Weather Vane Corp. (JV)                                                        | New York, New York      | 1967        | Poncho liners              | 2385    |
| 20. | BAC Machine Co., Inc.                                                              | Hawthorne, Calif.       | 1968        | Machine shop               | 3599    |
| 21. | Sverdrup & Parcel and Associates, Inc.                                             | St. Louis, Mo.          | 1973        | Engr. & architect. serv.   | 8911    |
| 22. | Sverdrup & Parcel and Associates, Inc.                                             | St. Louis, Mo.          | 1973        | Engr. & Architect. serv.   | 8911    |
| 23. | Micro Mfg. Co., Inc.                                                               | New York, New York      | 1968        | Small arm parts            | 3484    |
| 24. | Hercules Incorporated                                                              | Wilmington, Del.        | 1967        | Govt. plant operations     | 3901    |
| 25. | Hercules Incorporated                                                              | Wilmington, Del.        | 1968        | Govt. plant operations     | 3901    |
| 26. | Stupp Corporation                                                                  | Baton Rouge, La.        | 1973        | Bomb body tubes            | 3317    |
| 27. | Gillmore M. Perry                                                                  | Washington, D.C.        | 1968        | Manufacturer's rep.        | 5621    |
| 28. | Hupeman Brothers, Inc.                                                             | Waynesboro, Va.         | 1971        | Ship joiner                | 1751    |
| 29. | Hupeman Brothers, Inc.                                                             | Waynesboro, Va.         | 1972        | Ship joiner                | 1751    |
| 30. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1967        | Projectile shells          | 3483    |
| 31. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1968        | Projectile shells          | 3483    |
| 32. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1969        | Projectile shells          | 3483    |
| 33. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1970        | Projectile shells          | 3483    |
| 34. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1971        | Projectile shells          | 3483    |
| 35. | National Presto Industries, Inc. CONS                                              | Eau Claire, Wis.        | 1972        | Projectile shells          | 3483    |
| 36. | OEA, Inc SII to Ordnance Engineering<br>Associates, Inc.                           | Des Plaines, Ill.       | 1969        | Emergency escape systems   | 3728    |
| 37. | Pembroke, Inc.                                                                     | Egg Harbor City, N.J.   | 1972        | Military coats             | 2311    |

TABLE 1—Contractors

FY 1976

| No. | Name                               | Address                 | Fiscal<br>Year | Product or Service            | SIC<br>No. |
|-----|------------------------------------|-------------------------|----------------|-------------------------------|------------|
| 38. | Pembroke, Inc.                     | Egg Harbor City, N.J.   | 1973           | Military coats                | 2311       |
| 39. | Unaka Company, Incorporated CONS.  | Greenville, Tenn.       | 1967           | Bomb Ans                      | 3483       |
| 40. | Unaka Company, Incorporated CONS.  | Greenville, Tenn.       | 1968           | Bomb Ans                      | 3483       |
| 41. | The Austin Company, Incorporated   | Greenville, Tenn.       | 1966           | Wood pallets                  | 2448       |
| 42. | The Austin Company, Incorporated   | Greenville, Tenn.       | 1967           | Wood pallets                  | 2448       |
| 43. | Mullins Leaf Tobacco Company, Inc. | Mullins, South Carolina | 1966           | Personnel supply serv.        | 7369       |
| 44. | Mullins Leaf Tobacco Company, Inc. | Mullins, South Carolina | 1967           | Equipment rental              | 7394       |
| 45. | Sanford Tobacco Company, Inc.      | Sanford, North Carolina | 1968           | Wood pallets                  | 2448       |
| 46. | Leo A. Daly Company                | Omaha, Nebraska         | 1972           | Architectural & Engr. service | 8911       |

## 1977 Renegotiation Board Annual Report

TABLE I.—Contractors

| No. | Name                                                                     | Address                | Final Year | Product or Service                     | RIC No. |
|-----|--------------------------------------------------------------------------|------------------------|------------|----------------------------------------|---------|
| 1.  | Milan Box Corp.                                                          | Milan, Tenn.           | 1974       | Ammunition boxes                       | 2441    |
| 2.  | ABC Food Service, Inc.                                                   | El Paso, Tex.          | 1974       | Franchiser and services                | 7399    |
| 3.  | Overseas National Airways, Inc. SII to Automated Terminal Services, Inc. | Jamaica, N.Y.          | 1970       | Terminal operation                     | 4583    |
| 4.  | Reanord, Inc. SII to Nordberg Manufacturing Co.                          | Milwaukee, Wis.        | 1970       | Diesel engine parts                    | 3519    |
| 5.  | Aerodex, Inc. (CONS)                                                     | Miami, Fla.            | 1967       | Aircraft engine overhaul               | 3724    |
| 6.  | Fairchild Industries, Inc. (CONS)                                        | German-town, Md.       | 1967       | Aircraft components                    | 3723    |
| 7.  | Oso Corp.                                                                | Corpus Christi, Tex.   | 1972       | Equipment leasing                      | 7394    |
| 8.  | Medico Industries, Inc.                                                  | Wilkes-Barre, Pa.      | 1969       | Helicopter rockets                     | 3463    |
| 9.  | do                                                                       | do                     | 1970       | do                                     | 3463    |
| 10. | E. P. Stephenson & Blake Whitesell SII to All American Sales, Inc.       | Mobile Shosh, Ala.     | 1970       | Ammunition box hardware distributor    | 5073    |
| 11. | David B. Lilly Co., Inc.                                                 | Wilmington, Del.       | 1967       | Manufacturers' representative          | 5072    |
| 12. | David B. Lilly Co., Inc. SII to Delaware Fastener Corp.                  | do                     | 1967       | Bomb box parts distributor             | 5072    |
| 13. | do                                                                       | do                     | 1968       | do                                     | 5072    |
| 14. | do                                                                       | do                     | 1969       | do                                     | 5072    |
| 15. | Robert M. Hadley Co., Inc.                                               | Los Angeles, Calif.    | 1975       | Electronic transformers                | 3677    |
| 16. | Marvel Manufacturing Co.                                                 | Washington, D.C.       | 1968       | Propeller balancing instr.             | 3611    |
| 17. | do                                                                       | do                     | 1969       | do                                     | 3611    |
| 18. | The Windsor Manufacturing Co.                                            | Windsor, Conn.         | 1974       | Precision metal machining              | 3599    |
| 19. | Pembroke, Inc.                                                           | Egg Harbor City, N.J.  | 1974       | Costs and overcosts                    | 2311    |
| 20. | American Manufacturing Co. of Texas                                      | Fort Worth, Tex.       | 1966       | Bomb bodies and projectiles            | 3483    |
| 21. | do                                                                       | do                     | 1967       | do                                     | 3483    |
| 22. | do                                                                       | do                     | 1969       | do                                     | 3483    |
| 23. | do                                                                       | do                     | 1971       | Bombs                                  | 3483    |
| 24. | Industrial Park Supply Co.                                               | Fort Worth, Tex.       | 1960       | Bomb body material distributor         | 5051    |
| 25. | do                                                                       | do                     | 1970       | do                                     | 5051    |
| 26. | General Industrial Corp.                                                 | do                     | 1968       | do                                     | 5051    |
| 27. | do                                                                       | do                     | 1969       | do                                     | 5051    |
| 28. | do                                                                       | do                     | 1969       | do                                     | 5051    |
| 29. | do                                                                       | do                     | 1970       | do                                     | 5051    |
| 30. | do                                                                       | do                     | 1971       | do                                     | 5051    |
| 31. | Manpower, Inc.                                                           | Glendale, Wis.         | 1972       | Miss attendant services                | 7389    |
| 32. | Plastoid Corp.                                                           | Long Island City, N.Y. | 1966       | Wire and Cable                         | 3357    |
| 33. | do                                                                       | do                     | 1967       | do                                     | 7447    |
| 34. | do                                                                       | do                     | 1968       | do                                     | 47      |
| 35. | Lawrence Engineering & Supply, Inc.                                      | Burbank, Calif.        | 1974       | Fasteners distributor and manufacturer | 5072    |
| 36. | Service Equipment Co., Inc.                                              | Washington, D.C.       | 1972       | Manufacturers' representative          | 5023    |
| 37. | LaPointe Industries Inc. SII to Northeastern Engineering, Inc.           | Rockville, Conn.       | 1969       | Frequency counters                     | 3823    |

## 1978 Renegotiation Board Annual Report

TABLE I.—Contractors

| No. | Name                                                         | Address              | Fiscal year | Product or service                         | SIC No. |
|-----|--------------------------------------------------------------|----------------------|-------------|--------------------------------------------|---------|
| 1.  | U.S. Plastic Molding Corp.                                   | Melville, N.Y.       | 1965        | Plastic parts and assemblies               | 3070    |
| 2.  | ANF Inc. (CONS)                                              | White Plains, N.Y.   | 1969        | Bomb casings                               | 3453    |
| 3.  | Mason & Hauger-Silas Mason Co., Inc.                         | Lexington, Ky.       | 1966        | Government plant operations                | 3901    |
| 4.  | do.                                                          | do.                  | 1969        | do.                                        | 3901    |
| 5.  | Lucas Industries, Inc.                                       | Cullman, Ala.        | 1971        | Bomb dispensers and containers             | 3453    |
| 6.  | Continental Connector Corp.                                  | Woodside, N.Y.       | 1974        | Electronic connectors                      | 3675    |
| 7.  | Southern Fabricating Company, Inc.                           | Sheffield, Ala.      | 1966        | Ammunition box hardware                    | 3429    |
| 8.  | do.                                                          | do.                  | 1967        | do.                                        | 3429    |
| 9.  | do.                                                          | do.                  | 1968        | do.                                        | 3429    |
| 10. | Estate of Gilmore M. Perry                                   | Chesley Chase, Md.   | 1969        | Manufacturers' representative              | 5021    |
| 11. | do.                                                          | do.                  | 1970        | do.                                        | 5021    |
| 12. | do.                                                          | do.                  | 1971        | do.                                        | 5021    |
| 13. | do.                                                          | do.                  | 1972        | do.                                        | 5021    |
| 14. | do.                                                          | do.                  | 1974        | do.                                        | 5021    |
| 15. | do.                                                          | do.                  | 1975        | do.                                        | 5021    |
| 16. | Vinnell Corp.                                                | Alhambra, Calif.     | 1972        | Logistical services                        | 7369    |
| 17. | A. J. Industries, Inc. (CONS)                                | Los Angeles, Calif.  | 1973        | Fire bombs and airplane fuel systems       | 3153    |
| 18. | Stelma, Inc. SII to 1969 Delaware Corp. of same name         | Stanford, Conn.      | 1967        | Telecommunication equipment                | 3662    |
| 19. | Enlo M. Jorgensen Co.                                        | Los Angeles, Calif.  | 1975        | Faiged ship shuttles                       | 3462    |
| 20. | Hawmet Corp. SII to 1969 Delaware Corp. of same name         | Greenwich, Conn.     | 1971        | Super alloy castings                       | 3369    |
| 21. | EDC, Inc. (formerly Edgington Oil Co.)                       | Long Beach, Calif.   | 1974        | Jet fuel                                   | 2911    |
| 22. | do.                                                          | do.                  | 1975        | do.                                        | 2911    |
| 23. | FMC Corp. CONS                                               | Chicago, Ill.        | 1971        | Armored tracked vehicles                   | 3795    |
| 24. | Hercules Inc.                                                | Wilmington, Del.     | 1970        | Propellants, rocket motors, and explosives | 3901    |
| 25. | DeLong Corp. (New York) SII to DeLong Corp. (Delaware)       | New York, N.Y.       | 1969        | For barges and personnel supply            | 1629    |
| 26. | Paloran Products, Inc. (CONS)                                | Harrison, N.Y.       | 1969        | Bomb fuzes                                 | 3453    |
| 27. | Oss Corp.                                                    | Corpus Christi, Tex. | 1973        | Equipment leasing                          | 7394    |
| 28. | ABC Management Services, Inc.                                | El Paso, Tex.        | 1974        | Food and mass attendant services           | 7369    |
| 29. | ESL Inc.                                                     | Sunnyvale, Calif.    | 1974        | Reconnaissance and communication systems   | 3602    |
| 30. | OEA, Inc. (CONS)                                             | Des Plaines, Ill.    | 1970        | Emergency escape system devices            | 3726    |
| 31. | do.                                                          | do.                  | 1971        | do.                                        | 3726    |
| 32. | do.                                                          | do.                  | 1972        | do.                                        | 3726    |
| 33. | do.                                                          | do.                  | 1973        | do.                                        | 3726    |
| 34. | Norman S. Fish Engineering Co. d.b.a. Norman Engineering Co. | Los Angeles, Calif.  | 1974        | Architectural and engineering services     | 8911    |
| 35. | Tan-El Enterprises, Inc.                                     | New York, N.Y.       | 1971        | Textile converter                          | 3133    |
| 36. | Se-Sex Styles, Inc.                                          | Centex, Ala.         | 1973        | Field canteen                              | 5329    |
| 37. | MIB Associates                                               | San Ramon, Calif.    | 1973        | Chaff and chaff dispenser systems          | 3728    |

Chairman MINISH. Let me ask the gentleman, what is the difference between giving a sole source contract during war or not. You are spending more money now than you did during World War II.

Mr. McCLOSKEY. I would quite agree, but you point to the performance of this Agency during its last 3 years of existence. I doubt if any of the contracts listed there are sole source contracts. If you will look at those three exhibits at the end of my testimony, try to find a sole source contract against which excess profits were determined.

They all look as if they were competitive bidding.

Chairman MINISH. Well, it is evident that the Board went after the smaller contractors more than they did the big ones. I can agree with that.

Mr. McCLOSKEY. Mr. Chairman, this is a Board that was appointed primarily by Democratic Presidents over the last 30 years. There have been Republican Presidents in there, but in 1976, 1977, and 1978 this was the Carter administration.

Chairman MINISH. Well, the fact that he appointed them does not tell me that they are the kind of people I would like to have in there. It cannot be because any President appointed them that you can blame the President for not doing a good job.

Mr. McCLOSKEY. But you are asking to reinstitute a process under which both parties, according to you, appointed incompetent people. What guarantee would we have that a new President would appoint better people?

Chairman MINISH. I have faith that President Reagan would appoint the right kind of people.

Mr. McCLOSKEY. Well, I think you might be disappointed in his appointments. But under Jimmy Carter, with whom you should be satisfied, the Board never had a worse record than under the people appointed by Jimmy Carter. As a matter of fact, I do not think he filled two of the vacancies. When we finally abolished the Board, weren't there only three sitting members?

Chairman MINISH. I am not sure. I think you monitored that Board more than I did. But I would feel comfortable with President Reagan appointing the Board.

Mr. McCLOSKEY. You would?

Chairman MINISH. I sure would.

Mr. Barnard.

Mr. BARNARD. Thank you, Mr. Chairman.

Congressman, it is a pleasure to have you back before us on this biannual exercise of reestablishing the Renegotiation Board.

On the subject of sole source contracts, I just asked a question. Title X of the United States Code, chapter 131, section 2306, paragraph (d) says the fee for performing a cost-plus fixed fee contract—which I would so expect would be a sole source contract—for experimental, developmental, or research work may not be more than 15 percent of the estimated cost of the contract, not including the fee. The fee for performing a cost-plus fixed fee contract for architectural and engineering services for a public work or utility and so forth is 6 percent. And so it goes on.

Would you interpret from that that it is already in the law what the profits would be for a sole source contract?

Mr. McCLOSKEY. There is no inhibition in the law against the Defense Department imposing any conditions it wants, one of which could be reassessment of excess profits if they went above a given amount.

One of the problems with excess profits is that clearly in some businesses they expect to make a 3-percent profit, some an 8-percent profit. As I understood the Board's procedures, if an overcoat company, for example, were making an 8-percent profit on a given line of overcoats, they might then say to that company you cannot make more than 8 percent on your contracts with the Government.

But under the law there was no basic point at which an excess profit was determined. It could be 10 percent, 12 percent, 15 percent. It is very difficult for a contractor to know in advance what is going to be deemed to be excess.

It seems to me, in the sole source situation that you refer to, the best approach is for the Government and the contractor to work out what they will permit as acceptable profits, if that is the concern of the Government.

Mr. BARNARD. Congressman, have you ever known of a contractor who experienced a Government cost overrun to ever have made any money under that contract?

Mr. McCLOSKEY. I have not been in the business world for about 15 years, so I honestly do not know.

Mr. BARNARD. Well, that is one of the questions we need to explore. I cannot even imagine an occasion where a Government contractor, who has a cost overrun, makes any money. I do not believe that is the case.

Last year, if I might ask one further question, we had an amendment to the defense authorization bill, which repealed the Vinson-Trammell Act and was a substitute for it. That was not done, but the Vinson-Trammell Act was amended, to allow the President in wartime or national emergency to issue regulations to prevent excessive profits because Congress found that there were not excess profits in the present circumstances.

Wasn't that done instead of just repealing the Vinson-Trammell Act?

Mr. McCLOSKEY. That is correct. The Vinson-Trammell Act came into legal existence actually, as I recall, on September 30, 1976, when the Renegotiation Act expired. The problem with Vinson-Trammell was that both the Treasury Department and the Defense Department said it was going to cost \$100 million a year to administer. We are not sure it can be effective.

It applied, if you will recall, a 12-percent profit ceiling on aircraft, a 10-percent profit ceiling on ships, and no profit ceiling on things that went into other defense items. So that if you were, say, a radio manufacturer, you would have to keep three sets of records. If your radio part went into a ship or a plane or into a tank, there was no limit on the tank profit, 10 percent on the ship profit, and a 12-percent limit on the aircraft profits.

On that basis, after substantial hearings before the House Armed Services Committee—Chairman Stratton started out wanting to maintain some mechanism against excess profits—the committee agreed that it would in effect put Vinson-Trammell on the shelf,

repealing it until in time of war there appeared to be an emergency procurement situation that justified reimposing it.

That is the circumstance.

Mr. BARNARD. This was an act of Congress last year.

Mr. McCLOSKEY. That is correct.

Mr. BARNARD. No more questions.

Chairman MINISH. Mr. Parris.

Mr. PARRIS. Pete, is there any evidence to your knowledge that since the abolishment of the Board there has been an increase in the incidence of excessive profits by defense contractors?

Mr. McCLOSKEY. I have no evidence as to what has happened since the abolition of the Board.

Mr. PARRIS. Assuming that that is in fact correct, that there has not been any evidence of excessive profits. I gather from your testimony that you believe there is certainly no justification for reviving the Board at this time, given the safeguarding agencies that are in existence and in operation?

Mr. McCLOSKEY. None whatsoever. And note that in the new bill that the chairman has proposed there is a \$5 million floor. If you impose that \$5 million floor and a 15-percent profit level, and if the Board operated as it did in its last 3 years of existence—1976, 1977, and 1978—you would recover only \$6 million a year against a cost that is anywhere between \$100 million and \$160 million, depending on whose estimates are used.

Mr. PARRIS. I hope I can ask this question in what is intended to be a respectful way, Pete. In your long and distinguished career in the Congress, you have not clearly been recognized as one of those extremely rightwing conservative Members, certainly as measured by our side of the aisle.

I think you were present and heard most of my good friend from Maryland, Mr. Mitchell's, comments, in which he makes the point that it should be the proper function of Government—if I might summarize what I think he was saying—it should be the proper function of Government to establish the price in advance of the contract award.

There is a difference between buying airplanes and underwear for soldiers and I think what we are trying to get at here, it seems to me—or should be—is adequate competition. There is simply more competition in underwear than there is in airplanes.

My question to you, Pete, is do you agree with the general premise that was being advanced by the gentleman from Maryland that the Government should in fact get into the initial cost figure as opposed to the determination of excess profits or what have you?

Mr. McCLOSKEY. No; I do not agree with that. Every time the Government has tried to procure something or make something, the costs have generally exceeded that of competing small businesses. I might elaborate on that.

The point was made by one of your colleagues that if there is anybody hurt in the competitive enterprise system by having to perform more paperwork as a condition of doing business, it is small business. A small law firm that I used to run with 10 lawyers had to have the same number of accountants to meet the Government reporting requirements as a law firm of 100. So clearly the

small business becomes more costly in its competitive position by the imposition of Government paperwork requirements.

Again, I cannot give you a better exhibit than those three pages as to who was assessed excess profits. There is not a big business on that list that we all would know—a big defense contractor. They are all small businesses. So by imposing on 4,500 businesses the requirement of meeting paperwork requirements, you are making the smaller businesses less competitive, clearly, against the bigger businesses.

I do think that Chairman Mitchell of the Small Business Committee has a point when he says that you generally will get more competition from small businesses than you will from large ones. If you reinstitute this Board, you are making small businesses even less competitive because clearly the burden of this act falls more heavily on them. The only people ever reassessed appear to be small businesses or relatively small businesses.

Mr. PARRIS. I would be happy to yield to the chairman.

Chairman MINISH. I would like to remind my friend that during the last year the Board was in existence it assessed IBM \$40-plus million. Of course, once the Board went out, that was not followed up. I consider that a pretty big judgment.

Mr. McCLOSKEY. I only have the record to 1978. The Board went out of existence in March 1979. But if you look at 1978, of those 25 contractors, IBM is not on that list, is it?

Chairman MINISH. Your list is probably inaccurate.

Mr. McCLOSKEY. Pardon?

Chairman MINISH. Maybe your list is inaccurate.

Mr. McCLOSKEY. My list is precise. It is table 1, the list of contractors from the Renegotiation Board's report for the year 1978.

Chairman MINISH. Well, IBM was assessed by the Board overcharges for \$40-plus million.

Mr. PARRIS. In 1979.

Mr. McCLOSKEY. That would have had to have been in 1979. The Board was only in existence the first 3 months of 1979.

Chairman MINISH. Nevertheless, it was during the last year the Board was in existence. That is the point I am trying to make.

I would say that I am going to miss my friend from California. I would feel comfortable with him heading up that Renegotiation Board.

Mr. McCLOSKEY. Well, Mr. Chairman, you know I led the effort to end both the Renegotiation Board and Vinson-Trammell and I guess in my 15 years in Congress I have been identified with as many losing causes as has any Member. I have to say to the chairman: I admire your tenacity in continuing with what I view to be a losing cause.

Mr. PARRIS. My time has expired. Thank you.

Chairman MINISH. Mr. McCollum.

Mr. McCOLLUM. Thank you, Mr. Chairman.

Pete, you have indicated to us that you feel that in times of peace, which we have today, we do not need the Renegotiation Board. I assume that there are other agencies of Government that have an oversight function that would normally be expected to catch excess profits in normal times.

Could you run by some of those for us and whether you think they are effective at that?

Mr. McCLOSKEY. Well, as you know, probably the most effective oversight are the committees of Congress, which then lower the boom on the Navy or whoever is having cost overruns in the shipping business. I have been particularly aware of it because I have been the ranking member of the Merchant Marine and Fisheries Committee.

The shipyard overruns of companies such as Lockheed in Seattle and some of the shipping companies down in Mississippi have probably been the gravest examples of cost overruns, and the committees of Congress are on those big contractors like a hawk.

And yet—well, I will give you testimony that has been given to us privately from the shipyards. The shipyards will say when they contract for a Navy vessel as opposed to a civilian vessel they would rather almost automatically add 50 percent to the cost because they have to deal with the Navy inspectors, the Government inspectors, who are essentially trying to cut down the losses to the Government because Congress is looking over their shoulder and asking the Navy why these huge cost overruns occur.

So you have a mammoth oversight function. And, most of all, since we have enacted the original Renegotiation Act in 1942 and then renewed it in 1951, we have enacted a whole series of laws which require fair and accurate negotiation. The Truth in Negotiation Act requires the contractor to give you the full cost, and if they are wrong and overstate or understate costs, the contract can be subject to review.

We have the new procurement regulations and a whole series of acts that have been enacted in another committee on which I sit—the Government Operations Committee. Jack Brooks, the chairman, is familiar with this issue, with seven subcommittees of the Government Operations Committee looking at various items of Government procurement.

And yet it seems that every time we add additional procurement regulations we add to the cost the Government pays because the contractor, having to comply with those regulations, has to set aside accounting costs and legal fees to cover them. It is a never-ending contest between the Government and industry to try to keep costs down and meet the congressional oversight requirements.

And yet every law we pass, every regulation we pass adds a definable new cost to the very product we are buying. I think the balance today, is about as good as we can have.

Mr. McCOLLUM. It seems to me that we would do better with the moneys that we might otherwise be expending on this Renegotiation Board to provide continuing funding for those investigatory arms of either the committee or agencies involved currently in this oversight, and to increase it, if that is in fact what is required, rather than to reestablish the Board.

Is that what your conclusion is?

Mr. McCLOSKEY. That is correct and it is based on the Board's own records of those last 3 years that are included in my testimony.

I cannot justify 4,500 companies keeping records and yet only 25 to 30 in any given year being assessed an amount, which is only a fraction of the costs of recordkeeping. Bear in mind that if you recover \$20 million in excess profits, ordinarily 50 percent of that profit would come to the Government in income tax anyway, not necessarily. But when you take the taxes receivable on the profits, the cost of the Board, and then the cost of the paperwork, this Board was way out of whack as far as cost effectiveness to the Government in its last few years.

Mr. McCOLLUM. I yield back, Mr. Chairman.

Chairman MINISH. Mr. Weber.

Mr. WEBER. I was interested in your testimony on the top of page 3 because it coincides with a question I was going to ask. I did not know it was in your testimony.

The best means to handle situations where the Government fears an excess profit is to write into the request for proposals and procurement contracts a provision that the contractor will return any profit in excess of a given percentage stated by the Government. Can you tell me to what extent this type of clause is now being used in Federal procurement?

Mr. McCLOSKEY. I cannot. It would be a speculation.

Mr. WEBER. Is it used rarely or often?

Mr. McCLOSKEY. Again, my testimony would not be that of an expert on this point.

Mr. WEBER. So you would not be able to tell us how effective that type of thing is?

Mr. McCLOSKEY. No.

Mr. WEBER. How much different is this type of clause than what the Renegotiation Board would be doing anyway?

Mr. McCLOSKEY. Well, as I say, the Renegotiation Board's process apparently was to compare the profits of a given company in a given industry against the ordinary profits in that particular industry or of that particular company. There were cases clearly where, and I cited the Shoepak thermal boat example in 1950-51, for example, where suddenly services were needed in time of war to meet an emergency production.

Clearly neither the procurement officer nor the company could negotiate with any real anticipation of what kind of profits they might make. Nor could they do so, for example, if the order was for 10 times as much in the usual case.

I have no quarrel at all with a renegotiation provision, to say that if profits from a contract go above your average profits for the same material sold in the ordinary course of business they ought to be refunded to the Government. That would be an appropriate use, it seems to me, of that kind of a clause.

Mr. WEBER. You are also saying that during time of war this type of renegotiation is justified. Are you saying that the Vinson-Trammell Act gives us the handle on that that we need?

Mr. McCLOSKEY. The way it is written now, yes. Vinson-Trammell was enacted in 1934 when they were just getting into the development of an aircraft industry, an aircraft defense industry. They were possibly also looking ahead to World War II and the possibility of shipping expansion.

But, incidentally, it was interesting that they set a 12-percent profit ceiling on aircraft and only a 10-percent profit ceiling on shipping parts because they apparently wanted to give an incentive for the development of the then-infant aircraft industry.

But Vinson-Trammell was superseded by the Renegotiation Act in 1941. Then, following the enactment of this act, we enacted a whole series of new procurement regulations and cost accounting standards. The Truth in Negotiation Act added provisions to try to prevent precisely the kind of overcharging that could occur in time of war or phony negotiating that could occur in time of peace.

I think that set of laws has replaced the need for this act.

Mr. WEBER. I do not have any further questions. I yield back the balance of my time.

Chairman MINISH. Mr. McCloskey, do not the laws and regulations which have been put in place to control the procurement process only apply prior to the completion of a contract?

Mr. McCLOSKEY. I'm sorry, Mr. Chairman.

Chairman MINISH. Renegotiation only comes into play when a contract is completed. You mentioned the Truth in Negotiation Act and cost accounting with regard to military procurement. They affect the process prior to the completion of a contract.

The renegotiation process only deals with completed contracts.

Mr. McCLOSKEY. That is correct.

Chairman MINISH. It makes a big difference.

Mr. McCLOSKEY. Yes; but note the record. You might make an argument that you do not want to drive out of business companies who make profits. You are liable to get a better bid from a private contractor if he wants to make a profit and thinks he can make a profit.

All I am pointing to, Mr. Chairman, is that in the cases over a 3-year period where you had 46 in 1 year, 37 in another, and 37 in the third, the amount of money recovered to help the Government and the size of the companies that were reassessed profits are a drop in the bucket. You have 4,500 companies filing reports, but you went after somewhere between 37 and 46 relatively small companies and recovered a relatively small amount of money.

If there were ever any indication that this Board by its existence or by its performance saved the Government an immense sum of money, I think you could make a better argument for its perpetuation. But the record of the Board is a clear record. This was an agency that had lost its ability and certainly was not performing in a cost-effective way.

Chairman MINISH. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Congressman McCloskey, in your experience in this field, do you think we could really achieve the same goals that the Renegotiation Board would achieve by just improving the procurement procedures and maybe the quality of the people who are negotiating these contracts, or is that unreasonable to expect?

Mr. McCLOSKEY. I do not think the recreation of the Board would achieve anything except additional cost. Again, I point to its record of the last 3 years. The record is a fact. To suggest that by appointing better people to it or instituting better procedures to be used by

the Board itself, that it would do a better job, that is something that can only be speculated.

Mr. WORTLEY. I was referring more specifically to improving the procedures of the Defense Department in their procurement procedures.

Mr. McCLOSKEY. That is a constant battle. Cap Weinberger came into office known as "Mac the Knife," and I suspect he was appointed as Secretary of Defense because of his budget-cutting abilities and his knowledge of procurement as much as for his experience in matters of national security.

But I think we will always have a never-ending battle for better procurement procedures, better watchdogs, and better people, as well as the concern over the flow of armed services officers to companies that then sell to the Government, and vice versa.

Mr. WORTLEY. Are you aware of anything that has been done over there in DOD to improve their procurement procedures?

Mr. McCLOSKEY. Again, my testimony would be speculative, from reading the newspapers. I am not an expert. I know they are trying.

Mr. WORTLEY. Pete, you may have been involved with some losing causes in the past, but I think you are on the right track on this one. I hope you are a winner.

Mr. McCLOSKEY. At last. Thank you.

Mr. WORTLEY. I yield back the balance of my time, Mr. Chairman.

Chairman MINISH. I want to thank my friend. The chairman of your committee, whom you mentioned earlier, Mr. Brooks, supports the legislation.

Mr. McCLOSKEY. Glad to know that, Mr. Chairman.

If you do not have this, could I ask permission to submit for the record the testimony of Donald S. Grenough on June 18, 1981, before the Armed Services Committee. I think that as a former Director of the Renegotiation Board, his testimony ought to be a part of your record in this subcommittee. I have never read more persuasive testimony.

Chairman MINISH. On your side. [Laughter.]

Without objection, it will be in the record. Thank you.

[The statement of Donald S. Grenough on June 18, 1981, before the Procurement and Military Nuclear Systems Subcommittee of the House Armed Services Committee, submitted for the record by Mr. McCloskey, follows:]

#### WRITTEN STATEMENT OF DONALD S. GRENOUGH

My name is Donald S. Grenough and I am very pleased to have the opportunity to discuss with you today the subject of whether excess profit legislation is needed. I am a certified public accountant and a partner in Touche Ross & Co., an international accounting and auditing firm. My professional background includes over 30 years experience in industry, government and public accounting and consists primarily of work related to government contract matters. I was Director of Operations at the Renegotiation Board until June 1977, when I joined Touche Ross & Co. Based on my experience with the Board and related knowledge of contract matters, I would like to share some thoughts with you today on the subject of excess profits.

By way of background, we should recognize that our country has had almost 50 years of some type of excess profit legislation. The Vinson-Trammell Act of 1934 limited profit on ships and aircraft, and the Renegotiation Acts of 1942, 1943, and 1948 and 1951 prescribed specific factors to be considered in determining whether

contractors earned excessive profits on contracts with certain agencies. In its wisdom, the Congress refused to extend the Renegotiation Act beyond September 30, 1976, refused to fund the Renegotiation Board's operations after March 31, 1979 and the Board ceased to exist after that date. By law the Vinson-Trammell Act of 1934 became automatically applicable as of September 30, 1976.

During the past few years, various committees of Congress have heard a great deal of testimony regarding the Vinson-Trammell Act from interested parties including individuals, companies, trade associations, and government agencies. The consensus of such testimony is that for various reasons the Act should be abolished. I agree with the consensus, and will not take the time of this subcommittee to provide support for my position.

I would now like to explain some of my experiences at the Renegotiation Board to give you the benefit of my perception of the types circumstances that gave rise to excess profit determinations by the Board and to review these circumstances in the light of certain procurement improvements during the past 20 years. I hope this will be helpful to you as you consider whether or not the present environment of government procurement is one in which you deem it necessary to have some type of excess profit legislation.

I believe there are several different circumstances that caused the Board to make determinations of excess profits against companies, primarily during national emergencies when the largest amount of determinations were made.

For example, a lack of productive capacity in the market place for supplying certain goods and services, particularly wearing apparel, resulted in relatively high prices under Invitation for Bid (IFB) type contracting, with correspondingly high profit margins earned by companies awarded such contracts. The government needed large quantities of wearing apparel in relatively short periods of time which strained the capacity of the industry. In these circumstances, even IFB type contracting, which ordinarily yields the most competitive prices and is by statute the preferred method of contracting, resulted in profits determined by the Board to be excessive.

In addition, there were disagreements between contractor and Board personnel as to the amount of renegotiable profit. Most of these disagreements related to cost accounting matters, particularly the allocation of costs between renegotiable and non-renegotiable type work. In the absence of sufficiently authoritative cost accounting standards prior to the creation of the Cost Accounting Standards Board, the Renegotiation Board frequently made unilateral determinations of the amount of costs allocable to renegotiable sales which increased the amount of renegotiable profit from that reported by the contractor. The higher amount of renegotiable profit determined by the Board included some amount of profit deemed excessive by the Board, whereas the lower amount of profit reported by the contractor would not have included any excessive profit.

Contracting officers sometimes failed to adequately consider economies of scale in negotiating prices. When production increases, lower unit costs may result due to decreased costs per unit of production. For example, as larger volumes of procurement were negotiated with contractors, certain fixed type overhead costs were spread over more units of production, thereby decreasing unit costs. Since the amount of decreased unit cost was not properly considered by the government during contract negotiations, higher prices were negotiated. This resulted in the contractor earning profits that were in excess of amounts anticipated during negotiations. Some of these higher profits were determined excessive by the Board.

Differences of opinion existed between contractor and Board personnel as to the application of the statutory factors and this resulted in some excess profit determinations by the Board. For example, if costs incurred were less than estimated during contract negotiation, this would result in higher profits than anticipated by the contracting parties. Under these circumstances, the contractor may ascribe the high profits to cost efficiencies, including managerial skill, whereas the Board would contend that the high profits resulted from the negotiation of excessively high prices in the first instant.

Prior to enactment of defective pricing legislation, some contractors failed to disclose, during contract negotiation, certain cost information which could have resulted in the negotiation of lower prices if the government was aware of such information. Some of these cases resulted in excess profit determinations by the Board.

Having examined some of the circumstances that gave rise to excess profit determinations by the Board during the last 20 years, I believe it is appropriate to review these circumstances in the light of select improvements in our procurement environment during that time. While there has been many different improvements, I

will confine myself to those which have the most direct impact on the circumstances that caused excess profit determinations by the Board.

Invitation for Bid contracts, which accounted for large numbers of excess profit determinations, presently account for a relatively small percentage of defense procurement. IFB contracts are not required to be used in procurement, if it is determined that some form of negotiated contract is more appropriate. When a lack of capacity exists in the marketplace for producing goods and services, which may cause prices under IFB contracts to be high, the government can use various forms of negotiated contracts which permit pre-award audit of contractor proposed costs and profit. In these circumstances, the government is more likely to negotiate prices that do not include excessive profits.

During the last 20 years, the government has significantly changed the types of negotiated contracts it uses to best accomplish its procurement objectives. For example, incentive type contracts, including cost and performance incentives and cost sharing contracts are some of the negotiated contracts available to the government, in addition to the usual firm fixed price and cost plus fixed fee contracts.

Further, to the extent the government chooses to use the IFB contracting in non-wartime procurement, and there are many areas where it is entirely appropriate and can yield the most competitive prices, it should be recognized that certain risks and rewards are implicit in such contracting. In my opinion any profit or losses incurred by contractors under IFB contracting in non-wartime conditions should be viewed as the result of supply and demand in the free market, and should not be subject to excess profit legislation.

During the last 20 years negotiated procurement, including those on a sole source basis, have been subject to various legislative and regulatory changes as well as improvements in government audits and contracting officers negotiating skills. I am convinced that these type changes significantly address the circumstances that gave rise to many excessive profit determinations by the Board, thereby minimizing the possibility of excess profit in the future.

For example, defective pricing legislation requires the contractor to supply current complete and accurate cost information during contract price negotiations. This puts the government on an equal footing with the contractor and helps the government negotiate prices that do not contain excessive profit.

The Cost Accounting Standards Board (CASB) has promulgated 19 standards that are required to be followed by defense contractors in pricing contracts. Most of these authoritative standards were not applicable during most of the life of the Renegotiation Board. Many excessive profit determinations based on cost allocation disagreements between the contractor and the Renegotiation Board would not have been an issue and excessive profits would not have existed in such companies if the CASB promulgations were applicable to all the contracts reviewed by the Renegotiation Board during its entire life. Among other things, CASB requires consistent cost accounting from the price proposal stage through the cost accumulation stage. This decreases the possibility of a contractor earning excess profits on some contracts by changing cost accounting methods after contract award, since any change in cost accounting requires contract repricing.

The skill level of government auditors and contracting officers has increased considerably during the past 20 years, so that such personnel are more capable of evaluating historical and prospective cost information, including financial issues dealing with economies of scale, learning curves, and fixed and variable overhead cost issues. This permits the government to negotiate prices which include reasonable cost and profit projections, and minimizes the possibility of excess profits being negotiated in the prices.

I would like to discuss some cost/benefit issues that relate to excess profit legislation as administered by the Renegotiation Board.

Exclusive of excess profit determinations applicable to the Korean War, which were in excess of \$100 million per year, excess profit amounts determined by the Board during the last 20 years of its existence ranged from \$8 to \$70 million annually and averaged about \$30 million per year. Contractor appeals to the courts historically have reduced the recoverable amount by about 20 percent. Excessive profits were determined by the Board to be present mostly in other than very large companies; for example, during the 5 year period 1974-1978 only about 7 percent of the excess profit cases involved companies with renegotiable sales in excess of \$100 million annually.

During its life, about 5,000 contractors made filings each year with the Board. In my work with the Board I have reviewed thousands of those filings, and have made many visits to contractors locations to review accounting type data required to be maintained in support of the filing. I have examined the separate and detailed ac-

counting records required to be maintained, and analysis performed, to segregate renegotiable from non-renegotiable sales. I have also reviewed the different cost accounts required to be maintained, or special cost analysis required, to allocate costs to renegotiable sales for purposes of determining renegotiable profit.

I believe that maintaining accounting records, performing special analysis, and preparing the filings cost at least an average of \$20,000 per company, or a total of at least \$100 million per year. When the additional costs of renegotiation are included such as Board operations of about \$1 million per year, requests for additional information by the Board, conferences, legal and accounting fees, and Justice Department expenses, the minimum annual cost of renegotiation would be at least \$110 million. When this amount is compared with the \$30 million of excessive profit determinations described above, the cost/benefit value of excess profit legislation during the past 20 years becomes highly suspect.

Although most would agree that it is improper for individual companies to earn "excessive profits", however that may be defined, most would also agree that it is more improper to inflict an excess profit reporting system on contractors in our industrial base that does not pass a cost/benefit test. I believe that in a multi-billion dollar annual procurement environment it is not unreasonable to expect some contracts that result in a relatively high profit. However, a properly constituted cost/benefit analysis would not support excess profit legislation as a viable economic remedy when relatively few cases of excess profit may exist.

In summary, I would suggest to those who may believe that excess profit legislation is necessary in the present procurement environment, that recent, specific examples of actual companies who allegedly earned excess profit be examined to determine the procurement circumstances that resulted in such excess profits. To the extent that such cases exist, examination of them should be helpful in considering whether or not legislation is required to guard against future abuses.

I would caution the Congress to make itself fully aware of improvements in the procurement system that have occurred during the last 20 years, which in my opinion have eliminated the necessity for excess profit legislation in a non-wartime environment.

I would also suggest that excess profit legislation may be used by some contracting officers who may unduly rely on such legislation and thereby fail to exercise sound business judgment in contract procurement. I experienced a number of these situations when I was with the Board.

It is recognized that the significant build-up planned in our defense system during the next several years may be viewed as a natural impetus to some in Congress to rush headlong into some type of excess profit legislation. I would avoid this, and instead concentrate on a review and evaluation of the ability of government procurement personnel, the changes in procurement legislation and regulations during the past 20 years, the ongoing effort of the Office of Federal Procurement Policy to develop a new procurement system, the total cost/benefit result of any proposed legislation, and the basic integrity of the vast majority of companies who sell to the federal government.

That concludes my prepared testimony and I would be glad to discuss any of these matters with you.

**Chairman MINISH.** I want to insert for the record the statement of the gentleman from Pennsylvania, Mr. Murphy.

[Mr. Murphy's statement follows:]

#### STATEMENT OF HON. AUSTIN J. MURPHY

Thank you Mr. Chairman. I appreciate the opportunity to briefly testify in support of your efforts to reinstate the Renegotiation Board to review the Government's defense, space and related contracts.

As we all know our Nation is embarking on a huge military build-up which will involve the largest defense expenditures in our Nation's history. Over the next few years, the administration proposes to spend over a trillion dollars. Next fiscal year alone they will spend over \$177 billion, with almost half of that amount being spent on procurements, most of which will be going to contractors who are not required to engage in competitive bidding. These facts alone make it obvious that Congress needs to improve its oversight of military spending and I believe that H.R. 5651 addresses that need.

Mr. Chairman, there is not a Member of Congress that hasn't at one time or another spoken out about "waste, fraud and abuse in Government programs with the taxpayer's hard earned money." The current vogue is to come up with a short story

from time to time about someone who has cheated the Government, usually in connection with some welfare or human service program. And, perhaps, this is as it should be—we owe it to our constituents to always strive to eliminate such abuses. But long, long before there were welfare programs and food stamps, there was profiteering by Government contractors, including those dealing with military contracts. History records numerous instances during the Civil War where troops were supplied with uniforms and shoes that fell apart and rations that were inedible. And top dollar was paid for this material!

By no means am I suggesting that all or even a majority of contractors deliberately set out to defraud the Government. But it is true that there are those that have operated in less than an honorable fashion. Cost overruns are fairly common, sometimes with justification. But there are those instances when contractors engage in the practice called "buying in" whereby they deliberately submit a low bid to win a defense contract and later submit a claim to the Government contending that actual costs were higher due to supposedly unforeseen circumstances.

The General Accounting Office has released a report that states the Defense Department routinely gives contracts to consultants that are awarded without competitive bidding and continually renewed.

Costs for tanks, ships, planes, and missiles routinely escalate hundreds of thousands of dollars, and in some cases millions of dollars, for each one in short periods of time.

I recall reading a news article that concerned the new uniforms the Army has contracted to buy. They plan to spend about \$19 million and have already purchased 500,000 of these uniforms at a cost of \$37.50 each with plans to purchase thousands more. Since they were approved in 1979, the cost has risen by 50 percent. The only problem is that the uniforms shrink badly when they are washed. While this may be an extreme example, it does illustrate the two concerns I have with defense spending. (1) Why do these procurement contracts escalate in cost so rapidly and (2) why don't the items purchased work or function as they should?

With the massive amounts of tax dollars that will be going into the Defense Department at the expense of domestic programs and badly needed public works projects here at home, we owe it to the public to insure that this money is being spent wisely. We need a firm commitment to being frugal with tax dollars and by that I mean a commitment that will yield real results in battling waste, mismanagement and profiteering.

If excessive profiteering occurs as a result of this unprecedented expansion of military, peacetime spending, I fear our country will feel the repercussions for a long time. The administration claims that spending wildly does not bring about social change. If this is true then spending wildly on defense will do little to reduce U.S. vulnerability.

I know that some are reluctant to scrutinize the defense budget not only because of its sheer size but because of the complex national security issues that are involved. Some try to associate military spending with patriotism. But there is nothing patriotic in profiteering at the expense of the American taxpayer. And it is the ultimate insult to the men and women who proudly serve in our armed services.

There must be a coherent strategic plan for our defense spending that is guided by prudent fiscal management. The opportunity to improve our military capability should at all times be guided by a cost-conscious effort.

I believe H.R. 5651 addresses this goal.

Chairman MINISH. Will the gentlemen from the GAO come forward, please?

**STATEMENT OF DONALD J. HORAN, DIRECTOR, PROCUREMENT, LOGISTICS AND READINESS DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY SIDNEY WOLIN, GROUP DIRECTOR, PROCUREMENT, LOGISTICS AND READINESS DIVISION; JOHN BROSNAN, OFFICE OF GENERAL COUNSEL; AND JOHN POTOCHNEY, EVALUATOR, PROCUREMENT, LOGISTICS AND READINESS DIVISION**

Mr. HORAN. Mr. Chairman, I would first like to start out by introducing my associates who are with me.

On my left is Mr. Sidney Wolin, who is a Group Director in the Procurement, Logistics and Readiness Division, with long experience in auditing defense contract matters.

On my right is John Brosnan, who is an attorney with the Office of General Counsel and he is very familiar with the legal aspects of the renegotiation process.

On the far right is John Potochney, who is an evaluator with the Procurement, Logistics and Readiness Division of the General Accounting Office, also familiar with auditing of Government contracts.

Mr. Chairman and members of the subcommittee, we are pleased to be here today at the request of the subcommittee to present the General Accounting Office's views on the proposed legislation to revise and reinstate the Renegotiation Act of 1951. As you know, we have had a long and continuing interest in the renegotiation process because of our involvement in audits of the procurement activities of the Federal departments and agencies.

In testimony before this subcommittee in June 1975 we outlined and discussed the findings and recommendations of our study of the operations and activities of the Renegotiation Board. We also testified before this subcommittee in March 1977 in support of H.R. 4082, a bill to revise and extend the Renegotiation Act.

We have reviewed H.R. 5651 and want to express our continued support for legislation that would help insure that defense contractors do not realize excessive profits. We believe such controls are particularly important during periods of sharp increases in defense spending that could exacerbate the demands on the private sector, creating a sellers market, and reduce or eliminate the opportunities for effective price competition.

I would like to now offer some comments on certain aspects of the renegotiation process that warrant special attention.

Section 4 of the bill requires contractors to report renegotiable business on the basis of division and product line. We believe this would be a much needed improvement in the process. The prior method of renegotiation appeared to favor large diversified corporations because they could offset the results of high profit activities against the results of low profit or loss activities.

We believe this constituted an unfair advantage over smaller, single product line firms. Use of a product line approach would be more effective in reducing the number of large firms that were previously escaping renegotiation, and would place both large and small firms on a more equal footing.

The requirement for division and product line reporting should not create an unreasonable administrative burden. Most contractors maintain their accounting records on a divisional basis and the incidence of multiple product lines within divisions is generally not high. We believe that reporting procedures could be worked out by a reinstated Renegotiation Board that would minimize or prevent any significant administrative or reporting burden for contractors. We believe the Board should be given the necessary flexibility to work out these procedures.

Section 5 of the bill would raise the minimum levels of annual sales subject to renegotiation from \$1 million to \$5 million. In our previous testimony we said we had reservations with respect to

raising the minimum amount. Our 1973 report included an analysis of the number and amounts of excessive profit determinations made during fiscal years 1970-72 to determine those that would have escaped renegotiation if the minimum had been \$5 million.

Of the 450 excessive profit determinations totaling \$139 million, we found that about two-thirds of these, amounting to an estimated \$46 million, involved contractors with annual sales subject to renegotiation of less than \$5 million. We realize, of course, that during the period of our analysis there was no requirement for product line renegotiation. It is possible that product line renegotiation and the effects of inflation since the time of our analysis would bring in new contractors to offset the loss of revenue involved by raising the exemption level.

Our analysis of the Renegotiation Board's operations in the past led us to conclude that the Board's primary basis for measuring profits, to determine whether they were excessive, was to consider profit as a percentage of cost or price. We believe this is a simplistic approach which produces inequitable results and is not in accordance with the way the business and financial communities measure corporate results.

We believe the primary way to assess the reasonableness of a contractor's profit should be on the basis of "return on investment," with appropriate adjustments to recognize the statutory factors that are embodied in the Renegotiation Act.

In this connection, we have long advocated changes to profit negotiation policies toward the return on investment approach to provide incentives for contractors to acquire labor-saving modern equipment for use on Government contracts.

In our previous testimony, we pointed out that in making its excessive profit determinations the Board did not have written guidelines for applying and weighing the statutory factors. Rather, the amount of excessive profit was determined by subjectively applying the statutory factors.

The lack of guidelines and documentation supporting Board determinations made it almost impossible to tell whether they were made in a consistent and uniform manner. We believe that clear and specific written guidelines are needed to assist review officials in evaluating each factor and to allow all review levels to arrive at essentially the same decision. Guidelines would also enable the Board to more accurately tell contractors how excessive profit determinations were arrived at.

We have no indication that the Board made progress in developing such guidelines prior to disbanding. Therefore, it may be advisable to cover this matter in the proposed legislation.

During the first 21 years of the existence of the Renegotiation Act, contractors could appeal the Board's excessive profit determinations to the Tax Court. In the vast majority of cases appealed to the Tax Court, the Board's determinations were upheld. However, in 1972, the act was amended to shift appeals to the Court of Claims.

Because the Court of Claims has more detailed and formal procedures, cases take longer to be resolved, and compliance with the court's procedures is more costly to both the appellant and the

Government. More importantly, the Court of Claims appears to disagree with many of the Board's determinations of excessive profits.

A greater proportion of case decisions adjudicated by the Court of Claims have been unfavorable to the Government. In part, this has come about because the burden of proof under Tax Court decisions was on the contractor, whereas in the Court of Claims it is on the Government. As a result, the Government has not been very successful in providing the type of proof of excessive profits required by the Court of Claims.

With the current pattern of decisions by the Court of Claims, more contractors are likely to avail themselves of the appeal process. Unless the appeals are shifted back to the Tax Court or the Government can produce the type of proof demanded by the Court of Claims, the benefits derived from the renegotiation process will be greatly diminished.

Mr. Chairman, this completes my formal statement. We will be glad to respond to any questions.

Chairman MINISH. Thank you very much.

[Mr. Horan's prepared statement, on behalf of the General Accounting Office, follows:]

STATEMENT OF  
DONALD J. HORAN, DIRECTOR  
PROCUREMENT, LOGISTICS, AND READINESS DIVISION  
UNITED STATES GENERAL ACCOUNTING OFFICE  
BEFORE THE  
SUBCOMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATION  
OF THE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE  
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today at the request of the Subcommittee to present the General Accounting Office's views on the proposed legislation to revise and reinstate the Renegotiation Act of 1951. As you know, we have had a long and continuing interest in the renegotiation process because of our involvement in audits of the procurement activities of the Federal departments and agencies.

In testimony before this Subcommittee in June 1975 we outlined and discussed the findings and recommendations of our study of the operations and activities of the Renegotiation Board. We also testified before this subcommittee in March of 1977 in support of HR 4082, a bill to revise and extend the Renegotiation Act.

We have reviewed H.R. 5651 and want to express our continued support for legislation that would help ensure that defense contractors do not realize excessive profits.

We believe such controls are particularly important during periods of sharp increases in defense spending that could exacerbate the demands on the private sector, creating a sellers market, and reduce or eliminate the opportunities for effective price competition.

I would now like to offer some comments on certain aspects of the renegotiation process that warrant special attention.

#### Product Line Renegotiation

Section 4 of the bill requires contractors to report renegotiable business on the basis of division and product line. We believe this would be a much needed improvement in the renegotiation process. The prior method of renegotiation appeared to favor large diversified corporations because they could offset the results of high profit activities against the results of low profit or loss activities. We believe this constituted an unfair advantage over smaller, single product line, firms. Use of a product line approach would be more effective in reducing the number of large firms that were previously escaping renegotiation, and would place both large and small firms on a more equal footing.

The requirement for division and product line reporting should not create an unreasonable administrative burden. Most contractors maintain their accounting records on a divisional basis and the incidence of multiple product lines within divisions is generally not high. We believe that reporting procedures could be worked out by a reinstated Renegotiation Board that would minimize or prevent any significant administrative or reporting burden for contractors. We believe the Board should be given the necessary flexibility to work out these procedures.

Minimum Amounts Subject to Renegotiation

Section 5 of the bill would raise the minimum levels of annual sales subject to renegotiation from \$1 million to \$5 million. In our previous testimony, we said we had reservations with respect to raising the minimum amount. Our 1973 report included an analysis of the number and amounts of excessive profit determinations made during fiscal years 1970-72 to determine those that would have escaped renegotiation if the minimum had been \$5 million. Of the 450 excessive profit determinations totalling \$139 million, we found that about two-thirds of these, amounting to an estimated \$46 million, involved contractors with annual sales subject to negotiation of less than \$5 million. We realize, of course, that during the period of our analysis there was no requirement for product line renegotiation. It is possible that product line renegotiation and the effects of inflation since the time of our analysis would bring in new contractors to offset the loss of revenue involved by raising the exemption level.

Measuring Excessive Profits

Our analysis of the Renegotiation Board's operations in the past led us to conclude that the Board's primary basis for measuring profits, to determine whether they were excessive, was to consider profit as a percentage of cost or price. We believe this is a simplistic approach which produces inequitable results and is not in accordance with the way the business and financial communities measure corporate results.

We believe the primary way to assess the reasonableness of a contractor's profit should be on the basis of "return on investment", with appropriate adjustments to recognize the statutory factors that are embodied in the Renegotiation Act.

In this connection, we have long advocated changes to profit negotiation policies toward the return on investment approach to provide incentives for contractors to acquire labor saving modern equipment for use on Government contracts.

Guidelines for Applying Statutory Factors

In our previous testimony, we pointed out that in making its excessive profit determinations the Board did not have written guidelines for applying and weighting the statutory factors. Rather, the amount of excessive profit was determined by subjectively applying the statutory factors.

The lack of guidelines and documentation supporting Board determinations made it almost impossible to tell whether they were made in a consistent and uniform manner. We believe that clear and specific written guidelines are needed to assist review officials in evaluating each factor and to allow all review levels to arrive at essentially the same decision. Guidelines would also enable the Board to more accurately tell contractors how excessive profit determinations were arrived at.

We have no indication that the Board made progress in developing such guidelines prior to disbanding. Therefore, it may be advisable to cover this matter in the proposed legislation.

### Appeals From Excessive Profits Determinations

During the first 21 years of the existence of the Renegotiation Act, contractors could appeal the Board's excessive profit determinations to the Tax Court. In the vast majority of cases appealed to the Tax court the Board's determinations were upheld. However, in 1972 the Act was ammended to shift appeals to the Court of Claims.

Because the Court of Claims has more detailed and formal procedures, cases take longer to be resolved, and compliance with the Court's procedures is more costly to both the appellant and the Government. More importantly, the Court of Claims appears to disagree with many of the Board's determinations of excessive profits. A greater proportion of case decisions adjudicated by the Court of Claims have been unfavorable to the Government. In part this has come about because the burden of proof under Tax Court decisions was on the contractor, whereas in the Court of Claims it is on the Government. As a result, the Government has not been very successful in providing the type of proof of excessive profits required by the Court of Claims.

With the current pattern of decisions by the Court of Claims, more contractors are likely to avail themselves of the appeal process. Unless the appeals are shifted back to the Tax Court or the Government can produce the type of proof demanded by the Court the benefits derived from the Renegotiation process will be greatly diminished.

This completes my formal statement, Mr. Chairman. We will be glad to respond to any questions at this time.

Chairman MINISH. Mr. Barnard.

Mr. BARNARD. Mr. Horan, has the GAO made any recommendations to change the procurement practices for defense contracts?

Mr. HORAN. Yes, sir. Over the years we have made any number of recommendations that would improve the procurement process. One of the things going on right now, of course, is the effort by the Office of Federal Procurement Policy to develop a uniform procurement system, and our office has been very supportive of these efforts that would strengthen the procurement process, such as by trying to get better people in there and trying to develop competition generally.

Mr. BARNARD. Have your recommendations been generally accepted in this matter?

Mr. HORAN. Yes. I think overall our record has been pretty good. Especially on the recommendations we have made for systematic type improvements.

Mr. BARNARD. I am sort of rushing because I do not have but 5 minutes and I want to get in four questions—unless my chairman is going to give me some extra time.

In view of the fact that the GAO seems to think that because of the increased defense contracts there is a problem, why don't you recommend that they would reevaluate the procurement? Why not attack the problem from that end as opposed to the renegotiations end?

Mr. HORAN. Well, most of the reforms that we are talking about now have to do with improving the procurement process as it applies to developing the price in the beginning and in establishing what appears to be a fair and equitable price based on information available at the time the contract is awarded.

Unfortunately, there are many uncertainties and estimates and guestimates and changes in conditions which could make the end result quite a bit different from the going-in result.

Mr. BARNARD. You do believe in the competing process, though.

Mr. HORAN. Yes, sir.

Mr. BARNARD. You believe that free enterprise ought to be able to freely bid on Government contracts?

Mr. HORAN. Yes, sir. We are very supportive of the competitive way of doing business.

Mr. BARNARD. And just a quick question on the return on investment process. In this particular situation, would not the cost of labor be excluded?

Mr. WOLIN. No. Contractors would recover the cost of labor but cost of labor does not enter into the base for computation of profit if profit is based on return on investment.

Mr. BARNARD. What about cost of leasing?

Mr. WOLIN. No. Contractors would recover cost of leasing but it would be treated the same as labor costs for profit computation.

Mr. BARNARD. You are talking about return on investment. You are talking about capital investment?

Mr. WOLIN. That is right. It was investment by the contractor in the contract and a way of determining profits in addition to his costs. The things you are mentioning are costs. He will recover those, depending on the type of contract.

Mr. BARNARD. I was just wondering about that because I know a lot of Government contractors have to go out and lease new buildings. They have to lease new property. They have to hire a lot of additional people.

Mr. WOLIN. Those are costs. Costs are recoverable. But we are talking about a way of determining profit as based on return on the contractor's investment in the Government contract, rather than as a percentage of estimated costs to be incurred.

Mr. BARNARD. I understand what you said about the Court of Claims. I am just absolutely astounded. You think the Government is not being treated fairly in the Tax Courts?

Mr. HORAN. We really do not have a judgment on that.

Mr. BARNARD. You have made a judgment, Mr. Horan. You said right in this testimony that the Government does not get a fair break in the Court of Claims.

Mr. HORAN. No. We say the Government is not doing as well in the Court of Claims as it was in the Tax Court.

Mr. BARNARD. Well, that is the way I interpreted it. In other words, the citizens are getting a rap in the Tax Courts. I just do not see that at all.

It appears to me, that if we had the Court of Claims and it is a facility for the contractors to go to, and they are willing to pay the extra costs for this litigation, I think that it should stay there.

Mr. HORAN. Well, if they were paying it, I would agree with you.

Mr. BARNARD. Well, they pay a share of it.

Mr. HORAN. They are passing a lot of that on through their overhead costs to the Government too, so it may not be really so much of an investment by the contractor.

Mr. BARNARD. In 1980, Mr. Walter H. Sheeley of the GAO made this statement:

In conclusion, the General Accounting Office agrees that the Vinson-Trammell Act is outdated and should be replaced. We believe the question of whether this Act should be replaced with a new statute is a matter of policy which the Congress should determine after considering all of the advantages and disadvantages.

As a minimum, we suggest that a profit limitation statute that would become operative during a period of national emergency when contract activities increase significantly should be in place. We would also suggest as a minimum that the Secretaries of the various agencies should have the right to promulgate regulations that would limit profits in those cases where sole source contractors are attempting to tail unconscionable advantages of the situation.

Was that not passed into law last year?

Mr. HORAN. There is a provision to institute that.

Mr. BARNARD. So we actually did carry out the recommendation in that regard.

Mr. HORAN. Yes. That is the minimum thing we thought should be done and that was done, yes.

Mr. BARNARD. Thank you. I appreciate that.

Chairman MINISH. Mr. Parris.

Mr. PARRIS. Mr. Chairman, I had a fairly important call that I had to take and I missed the testimony. I am going to pass.

Chairman MINISH. Mr. McCollum.

Mr. MCCOLLUM. Thank you, Mr. Chairman.

Mr. Horan, in your testimony you state you want to express your continued support for legislation that would help insure that defense contractors do not realize excessive profits. Does this mean

that you fully support H.R. 5651, or do you have reservations about this particular bill?

Mr. HORAN. Well, there are a lot of things in terms of its implementation that we think we could work with the staff to work out some details.

The overall thrust of the legislation we interpret to be to add some measure of public confidence, I guess, in the procurement process that unreasonable profits are not being realized. We would, therefore, support this particular bill to accomplish that.

Mr. McCOLLUM. Can you red flag a couple of things that you do not like about this bill?

Mr. HORAN. Well, a few of the things that I mentioned my statement. I think the lack of guidelines as to what is an excessive profit.

Mr. McCOLLUM. The things you mention in your statement?

Mr. HORAN. Yes, sir.

Mr. McCOLLUM. Have there been any current studies to show what excess profits may be currently made by defense contractors or other Government contractors?

Mr. HORAN. That is one of the difficult things in trying to take a position on this kind of legislation in that there is really a lack of good information. We cannot go out there and come up with ready information as to whether profits are going up or down or what the range is.

There is just no reasonable way to accumulate that information and in fact that was one of the advantages of having the filings required by the Renegotiation Act. There was a central place, then, that somebody could go to and say here is what the contractors reported that the profits were. We no longer have that.

Mr. McCOLLUM. Am I correct, then, that there is no evidence that you have currently that defense contractors are realizing excessive profits?

Mr. HORAN. That is right.

Mr. McCOLLUM. Based on your general support for legislation to protect against these excessive profits, is it fair to conclude that you are dissatisfied with the existing safeguards such as the Defense Contract Audit Agency, the Truth in Negotiations Act, the armed services procurement regulations and Vinson-Trammell?

Mr. HORAN. Yes, sir. Our position is that those controls are not effective to assure that unreasonable or excessive profits are being realized. If someone is to take a position that we do not need to worry about excess profits because we have those things in place, we disagree with that. We do not think that that is true.

Mr. McCOLLUM. A few minutes ago I asked Congressman McCloskey about the fact that we might be better off using the funds not to set up this Board again but to add to the investigatory powers of the committees in Congress or to these agencies we did not name but that I had in mind.

What do you feel about that?

Mr. HORAN. I think there is a lot needed in that area. I am not so sure it is an either/or thing or whether you can do something on both sides.

I think the things that are in process—the strengthened procurement system, for example—are helping put the Government in a

better bargaining position at the front end of the contract and those are really important things. I think there is a lot needed to really get the Government in a position where it can bargain as an equal with the contractor and try to do the best job possible in assuring a fair price based on the information available at that time.

Mr. McCOLLUM. You think the Navy inspectors, for example, are doing their job in working on these shipbuilding programs? I am not talking about past history where we had all those problems. Are they doing fully what they should be right now?

Mr. HORAN. Well, you know, a lot of the inspectors and people out at the contractor's plant are really not there looking to prevent the contractor from realizing an unrealistic profit. They are out there to make sure the product itself is a quality product, to help resolve delivery and schedule problems, to see that he gets Government-furnished property on time, and that somebody is working on technical problems as they arise. But I do not think that there is an awful lot of Navy inspectors and the like.

Mr. McCOLLUM. Let me ask this way. Are you satisfied, though you want to see this additional Board involved, are you satisfied that the agencies that I named earlier are doing the job they were intended to do properly and adequately? Are they doing a good job of what they are intended to do, even though you may want to layer in another Board here?

Mr. HORAN. I do not think I can make an overall judgment that we are satisfied with the way that the Government contracts are being negotiated now or priced. We have got quite a number of audits underway right now that are looking at how good a job the Defense Contract Audit Agency is doing in establishing the price and assisting the Government negotiator in negotiating a fair and reasonable price.

Overall, we think that with the resources available to them they are doing a fairly good job. We are going to look at it a lot closer. Of course, it may turn out that we will find a problem.

Mr. McCOLLUM. Thank you. I yield back my time, Mr. Chairman.

Chairman MINISH. Thank you. Mr. Weber.

Mr. WEBER. Thank you, Mr. Chairman.

Mr. Horan, you heard the earlier dialog, I believe, that we had about whether the experience with the Renegotiation Board showed that the Board was actually costing more than the savings recovered. Do you have a comment on that? Could you clarify your position on that?

Mr. HORAN. Yes, sir. There are a couple of things that I think we can bring out. One is that there was a study that we made—I believe it was Senator Proxmire who asked the General Accounting Office to look at the cost to the contractors of complying with the renegotiation rulings and filing of information.

The job that we did ended up in a report to the chairman of the Committee on Banking, Housing and Urban Affairs, Senator Proxmire at the time, September 1977. Unfortunately, the conclusion is not all that useful in terms of deciding whether there is a high cost or a negligible cost.

To a large extent we found that the costs that were involved in accumulating information and preparing the reports was done by people who were doing many other things that would be required

and it was sort of a part-time thing. The incremental costs of doing this work just could not be split out to a point where we were satisfied that we could say it was x dollars versus y dollars.

We think there is a cost involved, but it did not appear to us to be, incrementally at least, significant, certainly as the contractors had claimed. Mr. Wolin I think has some details on that, if you would like to go further.

Mr. WEBER. All right, fine.

Mr. WOLIN. Basically, we found, as Mr. Horan pointed out, that these costs were integrated into the contractor's accounting system, his income tax accounting system, because they were asking similar bits of information. So, therefore, no person was entirely devoted to preparing a renegotiation report. Quite often they were spending maybe 1 to 5 percent of their time preparing a renegotiation report and they were not sure themselves because nobody kept any records of this sort of activity.

Now we did have some peculiarities among the contractors that had come forward to say that their costs were high. For example, one contractor had spent a lot of his money getting exemptions from renegotiation. In fact, this contractor got so many exemptions that he represented 8 percent of all renegotiation exemptions to all contractors doing business with the Government. He was obviously spending an inordinate amount and he is not a representative example.

The other contractors—and I think we had a total of eight that came forward during that hearing—the other seven by coincidence were all contractors who had been examined by the Board under a field review, which is a more extensive examination because apparently the Board felt that there were some indications of excessive profit.

This is more costly process than the typical contractor encounters. There was only one contractor in five that was ever subjected to a field review. So we had a bunch of unusual contractors who, although we could not come up with what any reliable estimate of costs contractors were incurring generally, whatever they the few individual contractors that came forward incurring was out of the ordinary.

That is the conclusion we could come to under this question. As far as an actual dollar amount, there was no way of coming up with that.

Mr. WEBER. I see.

Mr. HORAN. Excuse me, sir. There is another aspect to this that I think we ought to bring out. The product line reporting method we think would be less burdensome and less costly to the contractors because this is the way it appeared that they already kept records. So it would not involve as much consolidation and adjustment of existing records to report.

Mr. WEBER. Let me ask one more question. I am given to understand that in 1977 the GAO claimed that the Government was spending over \$1 billion a year for 54,000 employees who supervised procurement and contractors' performance under these contracts. Am I correct about that statement?

Mr. HORAN. I am not sure about the numbers. Mr. Wolin may answer it.

Mr. WOLIN. The number of employees is reasonably correct and probably the amount that the salaries cost is also correct. The bulk of these employees are quality control people in the Department of Defense. They have nothing whatsoever to do with the pricing of the contract or whether excess profits are being made under that contract.

The people that would be concerned with the pricing of the contract would be the DCAA, which has something like 3,000 individuals, and the contracting officer's staff, which may be a few more thousand. It is nowhere near 54,000 people involved in pricing contracts. It is probably less than 10,000 in total and these people are generally at the front end of the negotiation process. They are negotiating the initial prices of the contracts. They are not determining excessive profits.

They are determining whether the prices—based on the cost data submitted by the contractor in a noncompetitive situation—are accurate, current, and complete. They are trying to negotiate the best price they can for the Government.

There are instances in sole source situations where the contractor demands and gets an inordinate amount of profit. There is no way of recovery of that excess profit, if it exists, under the Truth in Negotiation Act or any other act other than excess profit legislation.

Mr. WEBER. Would you care to comment on Congressman McCloskey's suggestion that the best way to handle this is by a provision in the contract itself that calls for renegotiation or a remission of profit in excess of a designated percentage?

Mr. WOLIN. It sounds like an interesting concept. We do not know that this has ever been used in any contract that we know of where the contractor would agree at the outset of a contract to limit his profits to some percentage at the end. I do not know that it has ever been tried in practice.

Mr. HORAN. There would be one problem, possibly, with that. The contractor may not have as great an incentive to really do his best to bring down his costs of completing the contract if he knew that some of that money was going to be taken away.

Mr. WEBER. Is that any different than what we would have under a renegotiation? You can always have Parkinson's law that is going to fill up the amount of work to consume the dollars available.

Mr. HORAN. It is less likely that that would occur on an annual basis than on an individual contract, I think. It is hard to tell.

Mr. WEBER. Thank you.

Chairman MINISH. Mr. Wortley.

Mr. WORTLEY. Thank you, Mr. Chairman.

Mr. Horan, the Renegotiation Board was created in 1942 in World War II. It was reextended during the Korean war in 1951. These were all circumstances of wartime in which a lot of pressures existed on business as well as the Government—extreme pressures.

Do you think we ever would have had a Renegotiation Board if it was strictly peacetime?

Mr. HORAN. It is hard to say, but probably not.

Mr. WORTLEY. Well, why do we need it now?

Mr. HORAN. I think the one thing that concerns me personally about it is that without such a thing there is a high degree of uncertainty as to what is happening out there. I think if all of these controls that we have talked about before—the Truth in Negotiation Act and the cost accounting standards and the strong procurement force and all those things—were sufficient for me to say that should be enough, there should not be any cause for concern about this. The problem is those are things that are on the front end and are designed to help the Government do a good job of initial pricing.

Nobody knows because the information is not there. There is just a question of lack of assurance. Now maybe the renegotiation filing requirement itself could serve as a substantial deterrent to contractors who just would not want to have it known that they are making exorbitant profits and in pricing Government work they may do a better job.

Mr. WORTLEY. What is a "reasonable profit?"

Mr. HORAN. I do not know.

Mr. WORTLEY. You do not know. Well, you can take into consideration the capital investment that the manufacturer may have, the service that he is required to render in terms of delivery date, the quality of the product that he has to come up with.

Is there a difference between the profit of a manufacturer who supplies with capital goods or soft goods, maybe just a service? Do you take all those things into consideration?

Mr. HORAN. Those are the things that the Board is supposed to take into consideration. One of the defects, I guess, of not having a Board is that that is an arbitrary percentage.

Mr. WORTLEY. What is a "reasonable profit?"

Mr. HORAN. It is whatever the Board determines to be a reasonable profit—that group of people taking all those things into consideration.

Mr. WORTLEY. What are the other criteria other than the ones I just mentioned?

Mr. BROSNAN. The old statute had a number of general criteria. The initial one was the efficiency of the contractor, reasonableness of cost and profits, net worth, extent of risk assumed, nature and extent of contribution to defense effort, character of business, and a catchall; other factors which the public interest and fair dealing may require.

Essentially what you got into, especially in the court decisions, both by the Tax Court and the Court of Claims, was the Court considering these statutorily required factors and attempting to analyze the profit figures relating to the contractor's renegotiable business as compared to his commercial business—and sometimes to other similar industries dealing with the Department of Defense and coming up with a basic sort of seat-of-the-pants rule on each individual case.

Mr. WORTLEY. But you are flying by the seat of your pants. Is that what you are saying?

Mr. BROSNAN. I think that is basically what you are doing.

Mr. WORTLEY. What gives the Renegotiation Board the authority to fly by the seat of its pants? What makes you better than the

**manufacturer or the supplier who is determining what he thinks is a fair profit?**

**Mr. BROSNAN.** I guess the seat-of-the-pants theory is governed essentially by the statutory criteria.

**Mr. WORTLEY.** The taxes are what keeps the Government going.

**Mr. BROSNAN.** Taxes come in later. The Board does not figure the taxes initially. They come out of the finding, but they are not figured into the determination of whether profits are excessive or not. Because the Renegotiation Board as it was originally constituted did not issue detailed written opinion, it is difficult to really analyze exactly what they considered.

But the court opinions go through a fairly extensive analysis of the facts and law put forth by both the Government and the contractor and then come to a conclusion.

**Mr. WORTLEY.** It seems to me that we have enough agencies in Government that are breathing down the backs of the business community day in and day out without the Renegotiation agency. I think it is costing the taxpayers too much money.

My time has expired, I regret to say.

**Chairman MINISH.** Thank you.

First of all, I would like to point out for the record that the last full year of the budget for the Renegotiation Board was \$6 million.

**Mr. HORAN.** I do not quite understand what the opposition is to this legislation. It is a miniscule amount of money and, as I indicated earlier, the concerns of some of the Members and other people who are opposed to the legislation deal with the cost accounting of it. These are items or things that are done prior to the contract. Am I right on that?

**Mr. HORAN.** That is right. The cost accounting standards are simply just to make sure that the contractor is keeping his books so you can tell the costs that are chargeable to that particular contract. It has nothing to do with whether those costs are greatly less or more than what he estimated.

**Chairman MINISH.** The gentleman from Maryland, Mr. Mitchell, made a very important point. He said there are things that are done during a contract that are not negotiated in the sense that they negotiate it considering one method of production which can be shortened after time.

**Mr. HORAN.** Yes, sir.

**Chairman MINISH.** This situation can create an excess profit. I happen to know a little about that because I worked in a factory and I know there are changes in method, material or design, which can add to the profit margin. This situation is not looked into prior to the contract because in all fairness maybe the contractor himself did not know they could find a better way of doing the work. Or if he did, he did not tell. One or the other sure as heck happened.

I think it is most important that we have this type of legislation. I do not think it costs the amount of money that the companies and corporations have indicated. I saw an article where they quoted three different figures, in one of those magazines that comes across the desk once in a while.

I am appreciative of the support of the GAO. You certainly do not have any axe to grind other than protecting the American tax-

payer. I hope at the time that we bring this bill before the subcommittee to vote it up or down people will understand your position.

Also, I want to take the opportunity of thanking you and your organization for today's testimony and for that in the past. The staff will be getting in touch with you to get your views on some of the changes that can be made in the bill to improve it all around.

Mr. HORAN. Thank you, Mr. Chairman. We would be glad to help.

Chairman MINISH. The subcommittee will stand adjourned subject to the call of the Chair.

[Whereupon, at 1:24 o'clock p.m., the subcommittee adjourned, to reconvene upon the call of the Chair.]

[The following additional material was submitted for inclusion in the record:]



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

August 3, 1982

Honorable Joseph G. Minish, Chairman  
Subcommittee on General Oversight and  
Renegotiation of the  
Committee on Banking, Finance and Urban  
Affairs  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Chairman Minish:

Thank you for your recent invitation to participate  
in your hearings regarding H.R. 5551, a bill to revise  
and reinstate the Renegotiation Act of 1951.

Unfortunately, my schedule precludes me from participating  
in your hearing on August 4th. Should a future opportunity  
present itself to testify on other matters of mutual concern,  
please feel free to have your staff contact Lynn Skolnick  
(395-4790) of my Legislative Affairs Office.

Cordially,

  
David A. Stockman  
Director

Testimony of Hon. Charles E. Schumer on Renegotiation Act, submitted to  
House Banking Committee Subcommittee on General Oversight and Renegotiation

Mr. Chairman and Members of the Subcommittee on General Oversight and Renegotiation. I would first like to commend Mr. Minish for introducing H.R. 5651, to revise and reinstate the Renegotiation Act of 1951. Mr. Minish's continued support of defense contract renegotiation shows a loyalty to both the taxpayer and the Department of Defense; The Renegotiation Act of 1981 would ensure that our armed forces receive the best value for their procurement dollar while the taxpayers are given the full value of their tax dollar.

Reinstatement of the Renegotiation Act is important for the simple reason that there is very little competition among defense contracts for major weapons purchases. Few corporations are large enough to fill the large scale needs of our country's defense and space programs. The result is that most contracts are awarded to sole competitors; this produces a sellers' market with the government forced to "take it or leave it." The Government has no recourse but to pay whatever the contractor asks. Under these conditions there is little incentive for manufacturers to keep profits low.

The proposed Renegotiation Board would, as it did before the Act expired, review contracts and require the contractor to return what the Board judged to be excessive profits to the Treasury. Thus, the government would have the opportunity to compensate for the absence in the defense market of market-tested prices that can ensure a fair price when a contract is signed.

Renegotiation is not designed to punish manufacturers who supply our country's defense needs, but rather to ensure that the Government pays

no more than a fair price for these needs. The people of America have no desire to subsidize large defense contractors by allowing them to reap unearned excess profits. At a time when many in our country suffer the hardships of poverty, it is unconscionable that money collected to preserve the welfare of the people as a whole find its way instead into the hands of profit-seeking corporations in the form of excessive profits.

We have already cut the funding for domestic social programs to the bare bones for the sake of a defense budget that many of us consider bloated. At the very least, we owe it to the public to ensure that the money which we do spend on defense is not wasted. Reinstatement of the Renegotiation Act would be an important step toward that goal.

# MACHINERY and ALLIED PRODUCTS INSTITUTE

1200 EIGHTEENTH STREET, N.W. WASHINGTON, D.C. 20036 202-331-8430

August 13, 1982

The Honorable Joseph G. Minish  
Chairman, Subcommittee on General  
Oversight and Renegotiation  
Committee on Banking, Finance and  
Urban Affairs  
U.S. House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

In connection with the Subcommittee hearings last week on H.R. 5651, the proposed "Renegotiation Act Amendments of 1981," we wish to present the views of the Machinery and Allied Products Institute which represents the capital goods and allied product industries of the United States. Although most of the companies in these industries are oriented toward commercial rather than government sales, these companies rely heavily upon continuing technological development and product excellence and many of them are indispensable to the government's requirements, particularly in the national defense area. Hence, we have a special interest in defense contracts and in any proposed legislation, such as H.R. 5651, which would impose profit limitations on defense contracts and subcontracts by reinstituting statutory renegotiation under a resurrected Renegotiation Board.

This bill which you have sponsored together with nine of your colleagues, would (1) restore the Renegotiation Act as of the date of enactment of the bill and through September 30, 1986, (2) raise the floor on renegotiable sales subject to renegotiation from \$1 million to \$5 million, and (3) require that renegotiation be conducted on a product-line basis.

We strongly oppose H.R. 5651 and urge its rejection by the Subcommittee.

As for the bill itself, its enactment would make statutory renegotiation considerably more of a problem for industry than heretofore had been the case. Although the increase to \$5 million in the renegotiation floor would be a salutary revision, that would be more than offset, in our view, by the new requirement that renegotiation be conducted on a product-line basis. This requirement would inevitably increase and complicate contractor reporting requirements, and would also prevent the offsetting of losses on one product line against profits on another.



MACHINERY & ALLIED PRODUCTS INSTITUTE AND ITS AFFILIATED ORGANIZATION, COUNCIL FOR TECHNOLOGICAL ADVANCEMENT, ARE ENGAGED IN RESEARCH IN THE ECONOMICS OF CAPITAL GOODS (THE FACILITIES OF PRODUCTION, DISTRIBUTION, TRANSPORTATION, COMMUNICATION AND COMMERCE) IN ADVANCING THE TECHNOLOGY AND FURTHERING THE ECONOMIC PROGRESS OF THE UNITED STATES



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However, our basic objection to the bill goes beyond its specific provisions to the fundamental issue--is there a need for any type of statutory limitation on defense contractor profits at the present time? As you know, Congress has dealt with this issue on several occasions during the past seven years, beginning with the general oversight hearings conducted by this Subcommittee under your chairmanship in June 1975. On each of these occasions the continuance of such limitations has been decisively rejected. There has been no change in circumstances since then which would warrant any different disposition of the matter.

A brief review of how Congress has dealt with this issue--within the context of both the Renegotiation and the Vinson-Trammell Acts, the then-applicable profit limitation statutes--is relevant to this consideration and follows at this point.

#### The Expiration of Statutory Renegotiation

The Renegotiation Act of 1951 established the Renegotiation Board to examine profits under defense contracts and subcontracts during the Korean War and to recapture such profits to the extent they were determined to be excessive. The Act is not permanent legislation; as it now stands after 12 extensions, it applies to receipts and accruals reasonably attributable to performance of defense contracts and subcontracts prior to the close of the "termination date," currently September 30, 1976.

Following the general oversight hearings which were conducted by this Subcommittee in the summer of 1975, you introduced legislation to make the Renegotiation Act permanent legislation, provide for product-line renegotiation, and otherwise toughen the renegotiation process. This legislation, H.R. 10680, was approved by the House Banking Committee, passed by the House, but never acted upon by the Senate. As a result, the Act was not extended and the termination date remained September 30, 1976.

The following year you introduced H.R. 4082, virtually identical to the bill passed by the House the year before. The Banking Committee again approved this legislation with certain modifications--including a six-year extension of the Act rather than permanent status and an increase in the renegotiation floor to \$5 million. However, as you will recall, because of a decision by the House leadership, this legislation was never brought to the House floor for a vote; although no reason for this decision was stated, it was commonly understood that the reason was the virtual certainty that the bill would be rejected by the House. In any event, the bill died with the adjournment of the 95th Congress late in 1978 and matters remained as they were.

The failure of the House to act on extending the Renegotiation Board led the House Appropriations Committee to decide to fund the Renegotiation Board only through March 31, 1979, and this decision subsequently was sustained by both Houses of Congress. As a result, the Renegotiation Board terminated its operations as of that date. In a technical sense, it is true that the Renegotiation Act continues in the statute books, but as has been noted, it has no application to contractor receipts and accruals

attributable to post-September 30, 1976 contract performance. Moreover, the Renegotiation Board which was charged with the administration of the renegotiation process under the Act, no longer exists.

Thus, Congress had at least three major opportunities during this time period to extend statutory renegotiation, and on each occasion decisively rejected the idea.

#### The Vinson-Trammell Act

As a result of the nonextension of the Renegotiation Act, the Vinson-Trammell Act which had been suspended during the operation of the Renegotiation Act, automatically became applicable to the post-September 30, 1976 period. The Vinson-Trammell Act, as you will recall, imposed a 10 percent profit limitation on contracts and subcontracts for naval shipbuilding and a 12 percent limitation for contracts and subcontracts for military aircraft. There was general agreement that the Act as then worded was unworkable--a position with which we believe you concurred--and should not be enforced. Consequently, the Internal Revenue Service, charged with its administration and enforcement, successively deferred the due date for initial filings under the Act to October 15, 1980. And these administrative deferrals were further extended to October 1, 1981 by the enactment of the Fiscal Year 1981 Defense Authorization bill.

Last year, then, the question of what should be done with the Vinson-Trammell Act came up in connection with consideration of the FY 1982 Defense Authorization bill. The Reagan Administration recommended outright repeal which was accepted by the Senate. Congressman Price, Chairman of the House Armed Services Committee, at that point was undecided on the issue of outright repeal versus an alternative form of profit limitation and, as a result, this issue was considered in detail by the House Armed Services Subcommittee on Procurement and Military Nuclear Systems, chaired by Congressman Stratton of New York. As you will recall, the Stratton Subcommittee held three days of hearings, during which you and many other witnesses testified on the issue.

Following the hearings, the Subcommittee decided to recommend repeal of the Vinson-Trammell Act and the substitution in its place of a provision to authorize the President, upon a declaration of war or of national emergency, to prescribe such regulations to control excessive profits on defense contracts as he determines are necessary during such period. That provision was approved subsequently by both the House and the Senate and became law with the enactment of the FY 1982 Defense Authorization bill on December 1, 1981 (Public Law 97-86).

In its report on its hearings, the Stratton Subcommittee stated:

... As a result of the hearings, [we have] concluded that based on the prevailing evidence provided to the subcommittee, adequate procurement mechanisms already exist to deter a contractor from realizing an excess profit during peacetime, providing that responsible

government personnel properly utilize the existing mechanisms. /1

This judgment on the part of the Stratton Subcommittee, subsequently ratified by the Congress as a whole, was based on the position of the Defense Department as presented by Dr. Richard DeLauer, Under Secretary of Defense for Research and Engineering, and the endorsement of that position, separately and in their individual capacities, by the following senior procurement and logistics officials, both military and civilian, of the military departments and Defense Department components, each of whom testified at the hearings and made it clear that their positions on the matter were their own and had not been dictated either by the Defense Department or their superiors: /2

Vice Adm. Ernest R. Seymour, Commander, Naval Air Systems Command  
 Adm. Alfred J. Whittle, Jr., Chief of Naval Material  
 Gen. Robert T. Marsh, Commander, Air Force Systems Command  
 Gen. Bryce Poe II, Commander, Air Force Logistics Command  
 Lt. Gen. Harold F. Hardin, Deputy Commanding General for Materiel Readiness, U.S. Army Materiel Development and Readiness Command  
 Maj. Gen. Oscar C. Decker, Jr., Commander, U.S. Army Tank-Automotive Command  
 Rear Adm. Gerald J. Thompson, Deputy Director (Contract Administration Services), Defense Logistics Agency  
 Mr. Henry J. Dubricki, Deputy for Acquisition Policy, Office of the Assistant Secretary of the Army (Research, Development, and Acquisition)  
 Mr. Harvey J. Gordon, Deputy for Acquisition in the Office of the Deputy Assistant Secretary of the Air Force for Acquisition Management  
 Rear Adm. Joseph F. Sansone, Jr., Assistant Deputy Chief of Naval Material (Contracts and Business Management)  
 Mr. Alfred Volkman, Assistant to the Director, Acquisition and Contract Policy, Office of the Assistant Secretary of the Navy (Shipbuilding and Logistics)  
 Mr. Raymond F. Chiesa, Executive Director for Contracting, Defense Logistics Agency  
 Mr. Martin E. Smalling, Procurement Analyst and Coordinator of the Air Force's Procurement Management Review Program

- 1/ Profit Limitations on Defense Contracts, Report of the House Armed Services Procurement and Military Nuclear Systems Subcommittee, 97th Congress, 2d Session, August 4, 1981, p. 3.
- 2/ Vinson-Trammell Act of 1934 and the Necessity for Profit Limitations on Defense Contracts in the Current Contracting Environment, Hearings Before the House Armed Services Procurement and Military Nuclear Systems Subcommittee, 97th Congress, 1st Session, June 16, 17, 18, and August 4, 1981, pp. 124-204.

Mr. Stephen Parv'n, Contract Specialist, Headquarters, Naval Material Command, Contracts Directorate  
 Mr. John Alan Muller, Director of Procurement and Production, U.S. Army Missile Command  
 Col. John D. Slinkard, Deputy for Contracting, Air Force Electronics Systems Division  
 Col. Marvin G. Spallina, Director, Contracting and Manufacturing, Oklahoma City Air Materiel Area  
 Mr. Henry B. Jones, Director of Procurement and Production, U.S. Army Tank-Automotive Command  
 Capt. Stuart F. Platt, Deputy Commander for Contracts, Navy Sea Systems Command  
 Mr. John H. Lannen, Jr., Executive Director for Contracts Management, Naval Air Systems Command Contract Group  
 Col. Clarence W. Lee, Director for Contracting and Production, Defense Fuel Supply Center

Mr. Valeris O. Ewell, Jr., Director of the Acquisition Management Review Agency, Office of the Assistant Secretary of the Army for Research, Development, and Acquisition, was the only one of this group who dissented from the view that no alternative profit limitation was needed in peacetime.

The testimony of the other 21 members of this group as to the lack of need for statutory profit controls at the present time was substantially the same although with some differences in precise wording. Part of Admiral Whittle's statement, with its emphasis on the effect of profit limitations on the defense industrial base, warrants repetition:

If statutory limitations on profit did not exist I strongly believe we could create a better business-like environment with our defense industry [w]ith a mutual understanding that profits should be related to risk rather than being fixed. Both sides would have the flexibility to negotiate freely. The current unduly adversarial atmosphere between the Government and the defense industry could be diminished. The defense industry could assume its rightful role as a valued national asset and function as an equal member in partnership with DOD with one objective--maintaining the strongest defense force in the world.

I am convinced that profit limitations, such as those in the Vinson-Trammell Act, serve as one of many disincentives to contractors to enter the defense market place, thus eroding the defense industrial base. The most significant indicators of this are the steady decline in the number of defense contractors over the past few years, aging facilities, lack of critical material, and the reduction in a skilled labor force.

There is greater reliance on foreign manufacturing personnel and facilities, in some areas, it's as much as 70 percent./1

Admiral Whittle also noted, during his testimony, that cases which were cited by Admiral Rickover earlier in the hearings as justifying the need for statutory profit limitation, were based on contracts negotiated in the early 1970s, which, in his (Admiral Whittle's) view, are not typical of current procurement./2

We are aware of course that Mr. Donald J. Horan, Director of the Procurement, Logistics and Readiness Division of the General Accounting Office, who has endorsed H.R. 5651 before this Subcommittee, also testified before the Stratton Subcommittee that "some type of profit limitation statute is in the public interest."/3 However, neither Mr. Horan nor his associates from GAO were able to identify specific cases in which such a limitation was necessary or desirable. In our view--which obviously was the position of the Stratton Subcommittee--Mr. Horan's testimony did not serve to rebut the effect of the testimony of the DOD officials to the contrary.

#### Conclusion

Accordingly, it is clear on the basis of this record that the Congress, after opportunity for full public hearings on the matter, had decided to allow statutory renegotiation to expire and to repeal the Vinson-Trammell Act in favor of an authorization to the President to institute some form of profit control by regulation during war or national emergency. The desirability of an alternative profit limitation to apply in peacetime was carefully considered and rejected last year. We know of nothing that has happened since then to change that conclusion. For that reason, we urge the Subcommittee to reject H.R. 5651.

Respectfully,

*Charles Stewart*  
President

1/ Ibid., p. 133.

2/ Ibid., p. 134.

3/ Ibid., p. 35.